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IN THE

Supreme Court of the United States

October Term, 1958.

No. 369

R. H. MACY & CO., INC., L. BAMBERGER & CO., DAVISON-PAXON CO., and THE J. ASSMANN & KOCH COMPANY,

Petitioners,

v.

UNITED STATES OF AMERICA.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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September 15, 1958.

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R. H. Macy & Co., Inc., L. Bamberger & Co., Davison-Paxon Co. and The LaSalle & Koch Company [Macy] pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in this action May 12, 1958.

Opinions Below

The opinion of the district court (R. 32a-55a; App. 18-40) is reported at 148 F. Supp. 377. The opinions of the court of appeals reversing the judgment of the district court (R. 67b-78b; App. 1-12) and denying Macy's petition for rehearing (R. 129b-131b; App. 14-16) are reported at 255 F. 2d 884.

Jurisdiction

The judgment of the court of appeals was entered May 12, 1958 (R. 79b; App. 13). Rehearing was denied June 10, 1958 (R. 130b; App. 17). The jurisdiction of this Court is invoked under 28 U. S. C. 1254(1).

Questions Presented

Where Congress accords a statutory right to a class of persons, to be exercised pursuant to a regulation to be prescribed by a responsible agency officer, and that officer

(1) prescribes a regulation containing, *inter alia*, a cut-off date for the exercise of the right;

(2) until long after the cut-off date, interprets the statute and the regulation to deny the right to a part of the class; and

(3) thereafter, his interpretation of the statute having been held to be erroneous, reinterprets the regulation to accord the right to the entire class:

A. Had the officer, prior to reinterpretation, actually prescribed a regulation as to the originally excluded part of the class for exercise of the right accorded it by Congress?

B. Can the officer, after reinterpretation, validly invoke the cut-off date as to the originally excluded part of the class to deny it the right accorded by Congress?

Statutes and Regulations Involved

The statutes, regulations and rulings involved are set forth in the Appendix, pages 63-88.

Statement

This petition seeks review of a judgment denying Macy refund of federal income and excess profits taxes for fiscal 1942, with interest, in the amount of $1,008,750.21.

Although the decision of the court below is directed specifically to fiscal 1942, it necessarily has the effect of invalidating like claims for refund by Macy for fiscal years 1943 through 1947, which aggregate approximately $11,000,000.

Macy brought this action on October 26, 1954, in the United States District Court for the Southern District of New York. (R. 1a.) The basic facts in the case are not disputed, being agreed upon and stipulated by the parties. (R. 3a-31a; App. 41-62.) Those facts and pertinent statutory and administrative materials show:

1. The Purpose of LIFO in Federal Tax Accounting.

Steadily rising prices and depreciating currency values in the years immediately prior to World War II, prompted Congress in 1939 to amend the elective inventory provision (Section 22(d)) of the Internal Revenue Code of 1939, 53 Stat. 863 *et seq.* [Code]. Amendment was necessary so that all taxpayers (not merely producers and processors of certain nonferrous metals and tanners of hides and skins, as previously) could elect, if they so desired, to abandon a way of valuing inventory called FIFO, and adopt a new anti-inflation valuation called LIFO.

FIFO and LIFO are accounting techniques for valuing inventories. FIFO presumes that the first goods purchased are the first goods sold. LIFO, on the other hand, presumes that the last goods purchased are the first goods sold.

During a period of rising prices, the cost of goods sold is lower under FIFO, with the result that gross profit on

sales is greater. Conversely, under LIFO the cost of goods sold is higher during such a period and the gross profit on sales is lower. The reverse situations obtain in a period of falling prices. Thus, in comparison with FIFO, LIFO results in reporting a smaller gross profit during a period of rising prices and a larger gross profit during a period of falling prices.

2. The Retail Method and FIFO and LIFO.

The so-called retail method of inventorying determines inventories in terms of the aggregate of the retail selling prices of stock on hand rather than in terms of specific items of merchandise. Macy and most other retailers (with the sanction of the Commissioner under the general inventory regulation*) long have used the retail method in determining inventories for federal tax computation.

Both the FIFO and LIFO accounting techniques are applicable to the retail method of inventorying. The retail method, without more, automatically results in a FIFO valuation. To clearly reflect income and use the LIFO technique with the retail method, it is necessary (1) to inventory by departments within a store and (2) to adjust the closing inventory of each department by applying a price index to its aggregate retail value.**

3. The Original LIFO Statute.

Section 22(d) of the Code, as amended in 1939, provided that

> "(1) A taxpayer may use [LIFO] . . . in inventorying goods specified in an application [to use LIFO, as] required under paragraph (2) . . .

---

*Regulations 103, Sec. 19.22(c)-8. (App. 65-67.)

**For a fuller discussion of FIFO and LIFO, the retail method of inventorying and why departmental inventorying and price indices are necessary to the use of LIFO with the retail method, see *Hutzler Brothers Company*, 8 T. C. 14, 15, 23-27 (1947) and Mim. 6244, 1948-1 Cum. Bull. 21 (App. 83-88).

"(2) . . . [LIFO] may be used—

"(A) only in inventorying goods . . . specified in an application to use such method filed at such time and in such manner as the Commissioner may prescribe; and

"(B) only if the taxpayer establishes to the satisfaction of the Commissioner that the taxpayer has used no procedure other than [LIFO] . . . in inventorying (to ascertain income, profit, or loss, for credit purposes, or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries) such goods for any period beginning with or during the first taxable year for which the method described in paragraph (1) is to be used.

"(3) The change to, and the use of, [LIFO] . . . shall be in accordance with such regulations as the Commissioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income." 53 Stat. 877.

The Commissioner interpreted "goods" in Section 22(d) as requiring that inventories, to be eligible for LIFO treatment, be recorded in terms of physical items. Since, under the retail method, inventories are recorded only in terms of aggregate retail selling prices, the Commissioner, shortly after the 1939 amendment, took the position that the statute did not authorize retail method taxpayers to use the LIFO technique. (Pars. 7-8 of Stipulation of Facts, R. 8a, 9a; App. 46, 47.)

4. The Original LIFO Regulation.

Pursuant to the statutory direction that the "change to, and use of [LIFO] be in accordance with such regulations as the Commissioner . . . may prescribe", the Commissioner, in December 1939, promulgated the original

LIFO regulation. T. D. 4959, 1940-1 Cum. Bull. 22; Reg. 101, Arts. 22(d)-1 to 22(d)-6.* That regulation required, as a condition precedent to the election of LIFO, the filing of an application specifying the goods to which that inventory valuation technique was to be applied. Consistent with his interpretation of the LIFO statute, the Commissioner intended and interpreted the regulation to deny taxpayers using the retail method the right to elect LIFO (Paragraph 7 of Stipulation of Facts; App. 46-47.). Thus, he included in the original LIFO regulation a requirement for the matching of goods (Regs. 103, Sec. 19.22(d)-2; App. 69-74) with which retail method taxpayers could not comply and failed to include in that regulation provisions requiring the inventorying of goods by departments and for the use of price indices to adjust the retail method inventory to LIFO.

5. The 1942 Amendments to the LIFO Statute and Regulation.

Original subsection 22(d)(2)(B) of the Code denied an election of LIFO to taxpayers who, in the taxable year for which they wished to exercise their right to elect LIFO, had issued *interim* and or *annual* financial reports on a FIFO basis. In 1942, Congress amended that subsection retroactively to 1939, to deny such election only to taxpayers who, in such taxable year, had issued *annual* financial reports on a FIFO basis.

Shortly after that amendment of the statute, the Commissioner amended the original LIFO regulation to deal with taxpayers who, for all or part of the period 1939 to 1942, had been ineligible to elect to use LIFO only because they had published interim financial reports on a FIFO basis. Subsection 19.22(d)-3 of the original LIFO regulation, entitled *"Time and Manner of Making Election"*, was amended to read:

*Arts. 22(d)-1 to 22(d)-6 were adopted without amendment as Reg. 103, Sections 19.22(d)-1 to 19.22(d)-6. These Sections were amended by T. D. 5163, 1942-2 Cum. Bull. 80; T. D. 5400, 1942-2 Cum. Bull. 81; and T. D. 5605, 1948-1 Cum. Bull. 16 (App. 68-83)

> "[LIFO] . . . may be adopted and used only if the taxpayer files with his return for the taxable year as of the close of which the method is first to be used (or, if such return is filed prior to March 10, 1943, [*i.e.*, returns for the years 1939-1942] the ninetieth day after the approval of Treasury Decision 5199, then at any time prior to such date), in triplicate on Form 970 (revised), and pursuant to the instructions printed thereon and to the requirements of this section, a statement of his election to use such inventory method. . . ."

6. The Tax Court Holds That Section 22(d) of the Code Permits Retail Method Taxpayers to Elect LIFO.

By March 10, 1943, no more than seventy retail method taxpayers had filed, with their income tax returns for fiscal 1942, Treasury Form 970, seeking to elect LIFO (Par. 9 of Stipulation of Facts, R. 9a; App. 47). The Commissioner, of course, immediately denied the right of those taxpayers to elect LIFO. In 1947, a case that had been brought by one of those seventy was concluded adversely to the Commissioner. *Hutzler Brothers Company*, 8 T. C. 14 (1947). In that decision, which the Commissioner accepted without appeal, the Tax Court held retail method taxpayers not to be precluded from electing to use LIFO as permitted by Section 22(d) of the Code.

The breadth of the original LIFO regulation was not in issue in the *Hutzler* case. The sole issue there was the scope of the LIFO statute. However, in support of its contention that the LIFO statute did not apply to retail method taxpayers, the Government argued that the LIFO regulation clearly excluded retail method taxpayers and that the regulation was strong evidence of the meaning of the statute. The Tax Court, in answer, briefly adverted to the original LIFO regulation, stating that the Government's

". . . principal reliance, the interpretative regulations, will not withstand examination. . . . All of the regulations are as consistent with petitioner's position as they are with that of respondent. See, e.g., Regulations 103, secs. 19.22(c)-8 and 19.22(d)-3. It is simpler and more rewarding to seek the meaning of the statute itself than of ambiguous and largely irrelevant administrative interpretations." (8 T.C. at 28)*

7. The 1948 Amendments to the LIFO Regulation.

After the decision in *Hutzler*, the Commissioner in 1948 amended the LIFO regulation to make it applicable for the first time to retail method taxpayers (T. D. 5605, 1948-1 Cum. Bull. 16; App. 79). By those amendments, the Commissioner made provision (1) to inventory by departments within a store and (2) to adjust the closing inventory of each department by applying a price index to its aggregate retail value. The Commissioner also amended portions of the original LIFO regulation, with which retail method taxpayers could not comply, to exclude such taxpayers from their operation (App. 79-82).

The Commissioner, when promulgating the amendments, explained that

". . . [his] regulations with respect to . . . [LIFO] have heretofore made no provision for re-

*The Government, since *Hutzler*, has always contended that

". . . It was there [in *Hutzler*] successfully urged that the existing regulations, augmenting Section 22(d) of the 1939 Code, did not exclude department store retailers from adopting LIFO. Upholding this contention, the Tax Court did not invalidate the regulations." (Brief for Respondent, *Kaufman and Baer Co. v. United States*, No. 212, October Term, 1956, p. 11).

That erroneous reading of *Hutzler's* discussion of the original LIFO regulation was accepted by the court below [see R. 72b, 73b; App. 67]. When in *Joseph Horne Co. v. United States*, 161 F. Supp. 580 (Ct. Cl. 1958), the Government again advanced this contention as to the scope of the holding in *Hutzler*, its contention was expressly rejected. See R. 95b, 96b.

> tailers to group such goods into classes. The Bureau has held that the use of . . . [LIFO] was not available to taxpayers whose inventory records are kept on the basis of the retail inventory method permitted under . . . section 19.22(c)-8 of Regulations 103." (Mim. 6244, 1948-1 Cum. Bull. 21).

He also stated that the 1948 amendments to the LIFO regulation were made

> ". . . in order to adapt the retail inventory requirements of the regulations to the . . . [LIFO] inventory principle of Section 22(d) of the Internal Revenue Code as enunciated by the Tax Court of the United States in *Hutzler Bros. Co.*, (8 T. C., No. 3 [page 14])." (T. D. 5605, 1948-1 Cum. Bull. 16).

Those amendments were specified to be retroactive to all taxable years beginning after December 31, 1938.

8. The Commissioner Disallows the Macy LIFO Election and Claim for Refund at Issue in this Case.

Fiscal 1942 was the first year for which Macy qualified under the financial report requirements of Section 22(d)(2)(B) of the Code. As early as February 1942, Macy and other retailers, as well as representatives of the National Retail Dry Goods Association, had conferred with highly placed representatives of the Bureau of Internal Revenue in an effort to persuade the Commissioner to permit use of LIFO by Macy and other retailers. The conversations were unsuccessful and the Commissioner persisted in his adverse interpretation of the LIFO regulation. Macy did not file a Treasury Form 970 prior to March 10, 1943.

However, promptly after prescription of the 1948 amendments to the LIFO regulation, Macy did file Treasury Form 970, an amended return under LIFO for fiscal 1942 and the claims for refund at issue in this case.

In 1951, the Deputy Commissioner recommended that Macy's right to use LIFO, beginning with fiscal 1942, be recognized and, pursuant to that recommendation, the Internal Revenue Agent in Charge issued Revenue Agent Reports allowing LIFO to Macy for fiscal 1942.

Despite those actions by the Deputy Commissioner and the Internal Revenue Agent in Charge, the Commissioner in 1954 ruled that the omission by Macy to file Treasury Form 970 prior to March 10, 1943, barred its claim for refund. In so doing, the Commissioner rejected the position which he had maintained prior to 1948, that, since the original LIFO regulation (including "*The Time and Manner of Making Election*" subsection, which provides for filing Treasury Form 970) had been inapplicable to retail method taxpayers, those taxpayers had no authority or obligation to file Treasury Form 970 and their omission to do so was of no consequence.

9. Macy Brings the Instant Action.

On October 26, 1954, Macy sued the United States in the United States District Court for the Southern District of New York for the refund denied by the Commissioner. On cross-motions for summary judgment, based on stipulated facts, the district court on February 4, 1957 entered judgment for Macy. The United States appealed from that judgment and, on May 12, 1958, the court below reversed.

In both the district court and the court of appeals the Government rested its position on a single argument. It contended that, despite the inflexible position of the Commissioner until prescription of the amended LIFO regulation in 1948 that LIFO was not available to retail method taxpayers, the LIFO regulation had always prescribed the time and manner in which such taxpayers must elect to use LIFO.

The district court rejected that contention holding that, for purposes of deciding whether a retail method taxpayer had a right of election in the period 1942-1948 under the LIFO regulation, a court must attribute to the LIFO regulation the same meaning that the Commissioner in 1942-1948 intended and interpreted it to have. Specifically, the district court held that the "*Time and Manner of Making Election*" subsection of the LIFO regulation (subsection 3 of Section 19.22(d)-1) cannot be construed to have permitted a retail method taxpayer to elect LIFO at a time when the Commissioner was construing that subsection and every other subsection of the regulation to bar such an election. The district court thought it absurd for the Government to ascribe to the Commissioner

> "... a purpose to require a taxpayer to indulge in the idle and wasteful ceremony of filing a statement of an election the existence of which he steadfastly refused to recognize".

and observed,

> "... it would be rationally offensive to make provision for the time and manner of the filing of a statement of election by one in whom it is asserted, the right to make an election does not reside; and to whom the right to make the election is denied." (App. 32).

What seemed absurd to the district court was logic for the court below. The court of appeals held that, for purposes of deciding whether a retail method taxpayer had a right of election prior to amendment in 1948 of the original LIFO regulation, a court may give the regulation a different meaning than that which the Commissioner in 1942-1948 had intended and interpreted it to have.

The court of appeals believed it could justify this conclusion by looking to the first sentence of the LIFO regulation

(Regulations 103, Section 19.22(d)-1), which states that the LIFO regulation is applicable to all taxpayers permitted or required to take inventories under the general inventory provision of the Code (Section 22(c)) and under the general inventory regulation (Regulations 103, Section 19.22(c)). The court then looked to that subsection of the general inventory regulation which authorizes use of the retail method (subsection 19.22(c)-8), and concluded, without more, that the LIFO regulation had always been applicable to retail method taxpayers.

That reasoning ignores and gives no effect to the fact that the Commissioner had always intended and interpreted the original LIFO regulation to bar retail method taxpayers from electing the LIFO method. But, in the view of the court of appeals, that "rationally offensive" gap is of no concern, since collocations of certain words in the original LIFO regulation also appear in the LIFO statute—hence, the original LIFO regulation should be construed to have meant in the period 1942-1948 what the Tax Court in *Hutzler* held the LIFO statute to mean in 1947.

REASONS FOR GRANTING THE WRIT

I

The questions presented in this case are of importance in the administration of federal tax law and administrative law generally and have not been, but should be, decided by this Court.

(a) Throughout the United States there are, the Government has announced, a host of cases, identical with the instant case, in which

> "... claims [are at stake] estimated variously between $300,000,000.00 and one billion dollars." (App. 89-90)

The claims of Macy alone aggregate approximately $12,000,000. Thus, in its most narrow terms, the case is extremely important [see, *United States* v. *Zazove*, 334 U. S. 602]. Its review by this Court would furnish the rule for decision of the companion cases.

(b) It is not disputed that Congress intended to accord retail method taxpayers (like Macy) the right to elect LIFO. As is apparent from the enormous dollar total of similar pending claims, the vast majority of retail method taxpayers have been forced to seek to establish that right of election through litigation and, if the decision below is permitted to stand, will have lost that statutory right. Thus, the net result of the Commissioner's administration of the Congressional purpose through the original LIFO regulation, coupled with the rule of the decision below, will be to limit the statutory right to but a handful of a class of taxpayers that Congress intended to benefit. Where an inferior federal court cannot perceive precepts to prevent such a disparity between Congressional intention and administrative product, an important question of federal law is presented, review of which by this Court is necessary and appropriate.

(c) The decision below is also important in federal law because of the erroneous methodology of its approach to the interpretation of an administrative regulation. The Government urged below, and the court of appeals agreed, that, for purposes of determining whether in 1942-1948 the LIFO regulation prescribed the time and manner for retail method taxpayers to elect LIFO, it did not matter that the Commissioner in that period had misinterpreted the statute to deny them that right and, of course, similarly had intended and interpreted his regulation to deny it. According to the court below, what did matter was that the Commissioner had employed in drafting his regula-

tion many of the same word arrangements that Congress had used in drafting the statute. Hence, the problem of interpreting the regulation as of 1942-1948 became very simple, *viz.*, it must then have had the same meaning which the Tax Court in *Hutzler* held the statute to have. Thus, the "true" meaning (as contrasted with the Commissioner's own interpretation) of the regulation had always existed as a brooding omnipresence which accorded Macy and others a meaningful opportunity to exercise their statutory right to elect LIFO.*

It is well established that courts, to find the meaning of a federal administrative regulation, must look to the administrator's intention and interpretation when prescribing and administering the regulation. *Bowles v. Seminole Rock Co.*, 325 U. S. 410. Clearly, it is an important question whether persons affected by a federal administrative regulation may refer to that same source to seek the meaning of that regulation. To deny them that right can only proliferate administrative and judicial litigation.

II

The court below has decided important questions of federal law in a way that (i) is in conflict with decisions of another court of appeals and the Court of Claims on similar matters [*Pictorial Review Co. v. Helvering*, 68 F. 2d 760 (D. C. Cir. 1934); *Joseph Horne Co. v. United States*, 161 F. Supp. 580 (Ct. Cl. 1958)] and (ii) probably is in conflict with an applicable decision of this Court [*Manhattan Co. v. Commissioner*, 297 U. S. 129].

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*Contrast Judge Clark's acceptance of the methodology urged below by the Government with his rejection of that same methodology in Clark, *State Law in the Federal Courts: The Brooding Omnipresence of Erie v. Tompkins*, 55 Yale L. J. 267, 274-75 (1946).

(a) *Pictorial Review Co.* v. *Helvering*, 68 F. 2d 766 (D. C. Cir. 1934). The revenue statute involved in this case allowed affiliated corporations within the meaning of the statute to file either separate or consolidated returns, such election to be irrevocable. The Commissioner erroneously construed the statute and promulgated regulations in 1924 which precluded Excella Corporation from joining in a consolidated return with its affiliated group. Three years later, the Commissioner, recognizing his incorrect construction of the statute, amended the original regulations so that Excella qualified to elect to file as a member of its group. Excella so elected, and, thereafter, its affiliated group filed an amended return for 1924, claiming refund. The Commissioner resisted the claim on the ground that Excella had not made a timely election for 1924. The Court of Appeals for the District of Columbia Circuit sustained the election, holding (i) that, not until the initial regulations had been amended to conform to the statute did Excella's right of election come into being and (ii) that the failure of Excella to challenge the initial regulations did not bar its right of election.

The single distinction between *Pictorial Review* and the instant case is that, in the former, the Commissioner's erroneous interpretation of the statute was specifically expressed in his original regulation whereas, in the instant case, the Commissioner's erroneous interpretation of the statute was embodied in the original LIFO regulation primarily through his use in that regulation of the same arrangements of words which he had misconstrued in the statute.

The issue in both cases is at what point in time the regulation made the statutory right of election available to the taxpayer. The single distinction, if any, *i.e.*, the fortuity of the Commissioner's choice of language in his

original regulation, does not provide a rational basis for a difference in result.

Moreover, the bar in the original LIFO regulation to the election of LIFO by retail method taxpayers was no less explicit than the bar to election by Excella under the original consolidated return regulations. The original LIFO regulation required matching of goods (Regulations 103, Section 19.22(d)(2); App. 69-74), impossible for a retail method taxpayer, and omitted provisions for departmentalization of inventories and for use of price indices, provisions necessary for application of LIFO to the retail method. In 1948, the Commissioner found it necessary, not only to provide for departmentalization and for price indices, but also to exempt retail method taxpayers from complying with the matching of goods requirement. (See T. D. 5605, 1948-1 Cum. Bull. 16; App. 79-83.)

(b) *Joseph Horne Co. v. United States*, 161 F. Supp. 580 (Ct. Cl. 1958). This case involved the timeliness of an election of involuntary liquidation under Section 22(d)(6) of the Code. It was essential to decision in the case for the Court of Claims to determine the applicability of the original LIFO regulation to retail method taxpayers.

In holding for the taxpayer in *Horne*, the Court of Claims found that:

> "... until 1948, when the Commissioner amended his regulations, he was erroneously maintaining by *regulations* and practice the position that the LIFO method could not be used by department stores and others using the retail inventory method. *There were no regulations* or rulings prescribing procedures or standards to be followed by such taxpayers in computing their inventory valuations under the LIFO method." (emphasis supplied) [R. 115b]

On the other hand, the court below held that

> "... the whole regulation which the Commissioner issued to govern the use of LIFO was [ap-

> plicable to] . . . a taxpayer using the retail method of inventory valuation. . . ." [App. 7]

After the denial of rehearing below, the Government moved the Court of Claims for rehearing in *Horne*, and urged that the

> ". . . Court's opinion and findings [as to the applicability of the original LIFO regulations to retail method taxpayers] . . . are contrary to and conflict with a more recent decision relating to the same matters, *R. H. Macy & Co.* v. *United States* (C. A. 2d), decided May 12, 1958. . . ."*

The court below, in denying the Macy petition for rehearing, refused to recognize the basis of decision and the scope of the findings in the *Horne* case. Where *Horne* had found that, prior to 1948, there was no LIFO regulation applicable to retail method taxpayers, the court below answered the conflict with *Horne* merely be reiterating its conclusion that the original LIFO regulation did not preclude the filing of a LIFO return. Thus, the opinion below on rehearing does no more than emphasize the correctness of the Government's contention in *Horne* and petitioner's contention here that the decision below is in conflict with the decision of the Court of Claims in *Horne*.

(c) *Manhattan Co.* v. *Commissioner*, 297 U. S. 129. Misconstruing a section of the revenue statute, the Commissioner promulgated a regulation respecting methods of allocating the basis of securities acquired in non-taxable reorganizations. That erroneous regulation was in effect during the taxable year in issue. Thereafter, the Commissioner, discovering his error, amended the regulation to comply with Congressional intent. The case posed the ques-

*Defendant's Motion for a Rehearing, etc., *Joseph Horne Co.* v. *United States*, No. 141-54, Court of Claims, June 6, 1958.

tion whether the amount of the loss claimed by the taxpayer should be determined under the original or the amended regulation. This Court held that the original regulation was not efficacious to create any rights under the statute since a regulation which "... operates to create a rule out of harmony with the statute, is a mere nullity." (297 U. S. at 134.)

In rejecting the taxpayer's contention that the original rather than the amended regulation applied, this Court stated:

> "... the amended regulation, in effect became the primary and controlling rule in respect of the situation presented. It pointed the way, for the first time, for correctly applying the antecedent statute to a situation which arose under the statute. See *Titsworth* v. *Commissioner of Internal Revenue* (C. A. 3d) 73 F. (2d) 385, 386. The statute defines the rights of the taxpayer and fixes a standard by which such rights are to be measured. The regulation constitutes only a step in the administrative process. It does not, and could not, alter the statute ..." (*Id.* at 135.)

Thus, this Court held that promulgation by the Commissioner of an erroneous regulation cannot bar rights (the Commissioner's and, presumably, a taxpayer's) accorded by Congress and that the Commissioner's subsequent promulgation of a valid regulation is the first point in time at which statutory rights dependent on a regulation become fixed.

Applying the *Manhattan Co.* doctrine to the instant case, it is clear that the original LIFO regulation was, as to retail method taxpayers, invalid because under that regulation LIFO was denied to those taxpayers in the face of a statute which accorded LIFO to all taxpayers. In the *Manhattan Co.* case, the Commissioner's regulation on its face contradicted the statute; the statutory contradiction of the

original LIFO regulation, while not as apparent on its face (because, in part, it employed word arrangements from the LIFO statute), is no less real.* Any such distinction is obviously *de minimis*. Hence, as to retail method taxpayers, the first valid LIFO regulation was prescribed in 1948, when the Commissioner amended and reinterpreted the original LIFO regulation.

The absurd result of the decision below is that the Commissioner was able to promulgate a LIFO regulation in 1948 which, for the first time, was applicable to retail method taxpayers and to incorporate in that 1948 regulation a 1943 cut-off date, also applicable to those taxpayers. Clearly, the Commissioner could not have promulgated in 1942 a regulation fixing 1937 as the bar date; no more could he promulgate a regulation in 1948 fixing 1943 as a bar date. Any other conclusion frustrates the Congressional intent because it effectively destroys the right accorded retail method taxpayers to elect LIFO. The only alternative to reading the decision below as countenancing just such a result is to conclude that it conflicts with the principles laid down by this Court in the *Manhattan Co.* case.**

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*Nor can the government suggest a further distinction from the *Manhattan Co.* case by contending that its principles must be inapplicable here because to apply them would accord Macy "the benefit of six years' hindsight in deciding whether or not to elect LIFO for the fiscal year 1942" (App. 11). That suggestion assumes that Macy's filing of a Treasury Form 970 prior to March 10, 1943 would have lent it those six years of hindsight. This is simply not so. Each of the majority retail method taxpayers who did file Treasury Form 970 enjoyed the very same delay in making a binding election of LIFO, *i.e.*, at any time prior to the decision of the Tax Court in *Hutzler*, those taxpayers could have rescinded their election of LIFO by acquiescing in the Commissioner's pre-1948 interpretation of both statute and regulation.

**The principles of the *Manhattan Co.* case are not only of consuming importance in the tax field but also in the field of administrative law generally; for some non-tax cases, see, *e.g.*, *Woods v. Hyman Hotel Co.*, 177 F. 2d 543, 547 (8th Cir. 1949); *Martin v. Porter*, 157 F. 2d 35, 40 (9th Cir. 1946); and *Fleming v. Farmers Peanut Co.*, 128 F. 2d 404, 407 (5th Cir. 1942).

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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September 15, 1958.

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No. 369

In the Supreme Court of the United States

OCTOBER TERM, 1958

R. H. MACY & CO., INC., L. BAMBERGER & CO., DAVISON-PAXON CO., AND THE LASALLE & KOCH COMPANY,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

J. LEE RANKIN,
Solicitor General,
CHARLES K. RICE,
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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinions of the court of appeals reversing the judgment of the district court (Pet. App. 2–12) and denying taxpayers' petition for rehearing (Pet. App. 14–16) are reported at 255 F. 2d 884. The opinion of the district court (Pet. App. 18–40) is reported at 148 F. Supp. 377.

JURISDICTION

The judgment of the court of appeals was entered on May 12, 1958 (Pet. App. 13). Taxpayers' petition for rehearing was denied on June 16, 1958 (Pet. App.

17). Taxpayers' petition for a writ of certiorari was filed on September 15, 1958. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

QUESTION PRESENTED

Whether taxpayers were entitled in 1948 to recompute their taxable income for the fiscal year ended January 31, 1942, using the LIFO inventory method, where they had failed to file an election to do so prior to March 10, 1943, as required by the statute and regulations.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code of 1939 (§ 22 (c) and (d)) and of Treasury Regulations 103 (§§ 19.22 (c)–8 and 19.22 (d)–1 through 19.22 (d)–3) are set forth in the Appendix, *infra*, pp. 19–25.

STATEMENT

In 1948 Macy[1] filed an "election" of the LIFO method of accounting for its fiscal year 1942 and subsequent years and filed a claim for refund for 1942 on that basis. The Commissioner denied the claim for refund on the ground that under the statute and regulations the election for 1942 had to be made prior to March 10, 1943. Macy sued for refund, claiming that the cut-off date was inapplicable to it because the Commissioner had, until 1948, when his position

[1] Taxpayers are collectively referred to in the opinions below, and sometimes herein, simply as "Macy," since the taxpayers other than R. H. Macy & Co., Inc., have been liquidated and Macy stands in their place and stead with respect to the claims here involved (Pet. App. 55, 62).

was rejected by the Tax Court, asserted that the statute did not authorize "retail method" taxpayers, like Macy, to use LIFO techniques. The court of appeals held that Macy was barred from recomputing its 1942 taxes on the LIFO basis because of its failure to make a timely election. The material facts, as reflected in the opinions below (Pet. App. 2–12, 14–16, 18–40) and the stipulation of facts (Pet. App. 41–62), may be summarized as follows:

Under the LIFO (last-in-first-out) method of inventory valuation, the closing inventory, to the extent that it replaces the opening inventory, is assigned the same cost as the opening inventory; only the increase in the inventory, if any, is deemed to have been purchased during the year and is valued at current costs. Under the FIFO method (first-in-first-out), the opening inventory is assumed to have been the first sold during the year and the closing inventory is treated as consisting of the items purchased during the year, and hence is valued entirely at current costs. During a period of rising costs, the LIFO method is distinctively advantageous to a taxpayer, for, in effect, he is not required to include, as profit, increases in the value of the inventory (Pet. App. 3, 43–45).[1]

In filing its tax return for its fiscal year 1942, Macy, as it had in previous years, computed its income on the

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[1] This is true, in essence, because any costs incurred during the year which are attributed to the closing inventory cannot be deducted as part of the cost of goods sold. Thus the higher the closing inventory valuation, the lower the cost of goods sold and the higher the taxable income.

basis of the "retail method" of inventorying (Pet. App. 5). Under this method no records are kept of the kind or number of items on hand. The store simply adds up the retail prices of all the items on hand at the end of the year in each department and records the resulting total valuation as the "retail inventory." To arrive at a "cost inventory" this figure is then reduced by the standard percentage of mark-up in the department (Pet. App. 42–43, 45–46). Since this method is based on the current retail prices, it is essentially a FIFO method—the closing inventory reflects current costs rather than the cost of the opening inventory. To adjust this method to LIFO concepts, as Macy is seeking to do here, the closing retail valuation is "deflated" by means of a price index to beginning-of-the-year price levels and then compared to the opening inventory (Pet. App. 5). To the extent that the "deflated" value of the closing inventory is no greater than was the retail value of the opening inventory it is assigned the same cost; only the excess is revalued at year-end prices.[2] In effect, this adjustment treats all of the items in the department as being fungible and carries over the cost of the opening inventory without regard to whether the closing inventory includes the same kinds or numbers of items as the opening inventory (Pet. App. 19–20).

The use of the LIFO method of accounting for income tax purposes was first generally authorized by § 22 (d) of the Internal Revenue Code of 1939.

[2] For a detailed explanation of the application of LIFO concepts to the retail method of accounting, see *Hutzler Brothers Co.* v. *Commissioner*, 8 T. C. 14.

Section 22 (d) (2) (A) required taxpayers to make a binding election to use the method authorized by filing an application in the time and manner prescribed by the Commissioner. The Commissioner implemented the election provision in § 19.22 (d)–3 of Treasury Regulations 103, which, as amended, required that the election be filed with the return for the first year in which the method was to be used, except that the election could be made at any time prior to March 10, 1943, for any years returned before that date.[4] Upon filing such an election, the statute authorized the taxpayer to inventory "goods specified in the application" by treating "those remaining on hand at the close of the taxable year as

[4] The reason why taxpayers were given until March 10, 1943, to make an election for prior years was as follows: Section 22 (d) (2) (B) of the 1939 Code had originally precluded taxpayers from using the LIFO method if they had issued mid-year financial reports on another basis. The Revenue Act of 1942, effective October 21, 1942, had retroactively amended the section to eliminate the bar of inconsistent mid-year reports (though it retained the bar arising from inconsistent annual reports). In order to permit taxpayers who, because of inconsistent mid-year reports, had been barred from electing LIFO when they had filed their returns to take advantage of this retroactive amendment, the Commissioner amended the regulations to give such taxpayers 90 days after the amended regulations were issued (*i. e.*, until March 10, 1943) within which to make a retroactive election for years for which returns had already been filed. Macy was one of the taxpayers affected by the amendment to the statute, since for its fiscal year 1942 it had issued mid-year, but not annual, reports on a basis other than LIFO. Thus, although it had already filed its return for its fiscal year 1942 on a FIFO basis, it was given a further opportunity, until March 10, 1943, to make a retroactive election for that year.

being * * * those included in the opening inventory * * * to the extent thereof" (§ 22 (d) (1) (B)).

During the course of 1942, Macy and other retailers held numerous conferences with representatives of the Treasury Department in an attempt to persuade the Commissioner that the use of price indices to make "LIFO" adjustments to retail method inventories was within the accounting method authorized by § 22 (d). In these informal conferences (and, indeed, until 1948), the Commissioner took the position that the application of the statutory method required that the "goods" so to be inventoried be identified so that the "extent" to which those in the closing inventory were "included" in the opening inventory could be determined. Accordingly, it was his view that price-index adjustments to retail method inventories, which treated all the items in the department as fungible and made no identification of the items in the two inventories, were not authorized by the statute (Pet. App. 46–47).

In its tax return for fiscal 1942, timely filed on July 15, 1942, Macy reported its inventories with LIFO adjustments on the basis of price indices prepared by the National Industrial Conference Board. It computed its taxes due, however, without such adjustments and paid its taxes on that basis (Pet. App. 5). Although it was barred for other reasons from using LIFO adjustments when it filed its return, that bar was removed in October 1942; and, under the regulations, it still had until March 10, 1943, to make a

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See note 4, *supra*.

retroactive election for that year. That date, however, came and went without Macy filing the required notice of election, allegedly because of the Commissioner's opposition, which at that time had never been the subject of a formal ruling or decision (Pet. App. 5-6).

Some seventy other retailers, including Hutzler Brothers Company, refused to acquiesce in the Commissioner's informal position, however, and filed statements of election to use LIFO adjustments with their tax returns for fiscal years ended in 1942. They adjusted closing inventories to LIFO by using indices prepared by the National Industrial Conference Board (Pet. App. 6, 47).

On February 5, 1944, the Commissioner finally took a formal stand in opposition to the use of price-index adjustments to retail method inventories by issuing a deficiency notice to Hutzler Brothers Company, which had filed an election of LIFO with its return for the fiscal year ended January 31, 1942. (Pet. App. 54-55). The ensuing Tax Court proceedings resulted in a decision in favor of the taxpayer, holding that identification of goods was not necessary under the statute. *Hutzler Brothers Co.* v. *Commissioner*, 8 T. C. 14. The Commissioner acquiesced in the decision and amended his regulations, adding information concerning acceptable price indices and specifically authorizing the election of LIFO by retail method taxpayers. The Commissioner also issued Mim. 6244, 1948-1 Cum. Bull. 21, stating in detail

proper price indices and providing that retailers who had previously filed returns on the basis of LIFO using unacceptable indices could thereafter file amended returns for all "open" years based on indices acceptable to the Commissioner (Pet. App. 6–7).

In September or October, 1948, Macy filed notices of election to use LIFO for its fiscal year 1942, together with claims for refund of taxes paid for that year. In 1948 this year was still "open" for purposes of claiming refund. In 1954 the Commissioner disallowed Macy's claims for refund on the ground that it had failed to file a timely election to use LIFO for its fiscal year 1942—*i. e.*, on or before March 10, 1943—as required by the statute and regulations (Pet. App. 7).

Taxpayers then filed the instant suit for refund. The district court granted the taxpayers' motion for summary judgment on the ground that the regulations in force in 1943 were inapplicable to retail method taxpayers (Pet. App. 29–40). The court of appeals reversed, holding that the regulations were applicable to retail method taxpayers, so far as they went, and hence that taxpayers' right to elect LIFO for their fiscal year 1942 expired on March 10, 1943, pursuant to § 19.22 (d)–3 of Treasury Regulations 103 (Pet. App. 7–12).

ARGUMENT

The sole issue in this case is whether the requirement of § 19.22 (d)–3 of the LIFO regulations, that elections of the accounting method authorized by § 22

(d) of the Code be filed by March 10, 1943 (as to prior years), was applicable to taxpayers claiming a right under that section to make LIFO adjustments to retail method inventories. The court of appeals held that it was. That decision was clearly correct and there is no conflict of decisions or other appropriate ground for review by this Court.

1. Petitioners argue that the regulations issued to implement § 22 (d) (Treas. Regs. 103, §§ 19.22 (d)–1 through 19.22 (d)–3, *infra*, pp. 21–25) interpreted the statute as not authorizing the method they sought to employ and hence that the filing requirements were not applicable to them. That argument is unsound.

a. Petitioners concede that the implementing regulations used "the same arrangement of words" as the statute (Pet. 15). That being so, it is difficult to see how the regulations can be read as being of any narrower scope than the statute itself. Petitioners' sole argument is that, since the Commissioner believed that the statutory language did not authorize the price-index adjustments they sought to make, he must have intended those words, when used in the regulations, to "mean" that such adjustments could not be made. The argument is untenable. That the Commissioner believed that the statute did not apply does not mean that he intended his regulations, cast in the same language, to foreclose the issue.

In any event, it is clear, as the court of appeals pointed out, that the regulations were, if anything, more consistent with petitioners' position than was

the statute itself. For example, § 19.22 (d)-1 authorized the use of the statutory method by "Any taxpayer permitted or required to take inventories pursuant to * * * the provisions of sections 19.22 (c)-1 to 19.22 (c)-8" of the regulations. Since § 19.22 (c)-8 is the provision expressly governing the use of the retail method, that cross-reference on its face seems to have expressly contemplated the election of LIFO by retail method taxpayers. Petitioners rely primarily on the several references in the regulations to "specification" of the "goods" to be inventoried (*e. g.*, §§ 19.22 (d)-2, 19.22 (d)-3), but that language was derived from, and thus was no more stringent than, the statute itself. Clearly, therefore, so far as the regulations elaborated on the statutory requirements at all, they were, as the Tax Court recognized in *Hutzler Brothers Co.* v. *Commissioner*, 8 T. C. 14, 28, fully consistent with the use of LIFO adjustments by retail method taxpayers.

Petitioners seek to buttress their argument by pointing out that the regulations *omitted* certain provisions that might have been appropriate if the Commissioner had contemplated that retail method taxpayers would be entitled to adjust their inventories to LIFO by the use of price indices—for example, a prescription of the proper indices to use (Pet. 6, 16). To the extent that that is true,[6] it is irrelevant. The

[6] Petitioners' suggestion that the regulations did not originally provide for departmentalization of inventories (Pet. 16) would not appear to be accurate. Although the sections dealing with the use of the LIFO method did not expressly so provide, § 19.22 (c)-8, the provision generally dealing with the retail

statutory right to the use of the LIFO method was self-executing (except possibly for some provision for the filing of elections) and did not require implementation by the Commissioner—as, indeed, the *Hutzler* case itself establishes. Under § 22 (d) (3), which authorized the Commissioner to prescribe "such regulations * * * as necessary in order that the use of such method may clearly reflect income," there is no doubt that the Commissioner had the *power* to prescribe, for example, appropriate price indices. It is equally clear, however, that he was not required to do so. That he did not, reflects at most his view that the use of price indices was not authorized by the statute and hence that it was not necessary to prescribe them. Moreover, the regulations themselves recognized that they were not intended to spell out every proper method that might be used and concluded by authorizing "any other proper method which, in the opinion of the Commissioner, clearly reflects income" (§ 19.22 (d)-2 (4) (d)). Clearly, therefore, if retail method taxpayers were entitled under the statute to make price-index adjustments to their inventories, nothing in the regulations precluded them from doing so or from using any price index that seemed to them appropriate. If the Commissioner later disapproved of the price index chosen, that could mean at most only a recomputation on the basis of an acceptable index—as, indeed, proved to be true as to the many retail method taxpayers who did make a timely election.

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method (and to which a cross-reference is made in the LIFO provisions, see § 19.22 (d)-1) did specifically provide for departmentalization of inventories and for various cost adjustments to eliminate distortions from the retail method.

It is clear, therefore, that petitioners' failure to file a timely election was not because anything in the regulations precluded them from doing so. At most it was solely because the Commissioner in informal conferences took the view that the method they sought to use was not authorized by the statute. But the petitioners were free either to acquiesce in that view or, if they thought it erroneous, to file a timely election and challenge it. Obviously the fact that their claim would be resisted could not relieve them of the obligation to assert it. Indeed, even where the Commissioner challenges action which he had previously approved, the taxpayer is not entitled to rely upon the erroneous interpretation of law upon which the approval was based. *Automobile Club* v. *Commissioner,* 353 U. S. 180. And here the Commissioner is not challenging any action taken by petitioners in "reliance" upon his advice. It is the petitioners who are now claiming that they were entitled to do something else. In effect, they are simply seeking a benefit which they failed to claim within the time allowed by law, allegedly because they were told by an adversary (quite accurately) that the claim would be resisted.

b. In any event, even if the regulations *had* interpreted the statute as not authorizing the use of LIFO adjustments by retail method taxpayers, it would by no means follow that the *filing* requirement would not be applicable to anyone who sought to challenge that interpretation. Section 19.22 (d)–3 of the regulations provided that "The elective inventory method may be adopted and used only if the taxpayer files

[prior to March 10, 1943 [7]] * * * a statement of his election to use such inventory method." In terms this applied to *anyone* seeking to use the elective method, and its clear meaning was that *any* election to use LIFO had to be filed within the time specified.

Nor is there any reason to construe the filing requirement as not applying to an election by a taxpayer whose right under the statute to make the election was questioned by the Commissioner. The purpose of requiring a taxpayer to make a binding election in advance was to prevent him from waiting to see the outcome and then recomputing his taxes on the method producing the least tax. That purpose is equally as applicable to a taxpayer whose right is disputed as it is to one whose right is clear. To impute to the Commissioner a purpose to prescribe a time limit only for elections of methods clearly within the statute and to impose no limit on the election of methods he considered not to be within the statute would be to ignore the whole purpose of the requirement.

Petitioners' sole reliance for their basic premise is upon *Pictorial Review Co.* v. *Helvering*, 68 F. 2d 766 (C. A. D. C.). The very basis of that decision, however, was the court's holding that the original regulation there involved was a valid exercise of the Commissioner's delegated power to *bar* the taxpayer from filing a consolidated return and operated by force of law to *require* the taxpayer to file a separate return. It followed that, since the taxpayer in fact had no

[7] See note 4, *supra*.

right to file a consolidated return, its failure to do so was not an "election" which prevented it from doing so when the regulation was changed. Here, on the other hand, the regulations are not claimed to have been anything other than "interpretive" and there is no suggestion that the Commissioner purported to exercise a delegated power to prescribe what methods of inventory accounting could be used. To the contrary, it is established by the *Hutzler* case that the regulations did *not* operate to preclude persons in petitioners' position from adopting the controverted method. Hence, unlike the taxpayer in *Pictorial Review*, the petitioners here had a complete and present right in 1942 to make the now-desired election. Having chosen to acquiesce in the Commissioner's view rather than exercise their existing right to file an application and challenge his interpretation of the statute (whether or not embodied in the regulations), there is no reason now to relieve them from the consequences of their choice.[8]

2. The conflict asserted by taxpayers does not exist. To the contrary, the instant decision by the Second

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[8] Petitioners' characterization of the *Pictorial Review* case as holding "that the failure of Excella to challenge the initial regulations did not bar its right of election" (Pet. 15) is simply erroneous. The whole point of the decision was that the initial regulations were valid and binding and *could not* have been successfully challenged. Petitioners' alternative (and, it would seem, inconsistent) statement of the holding as being "that, not until the initial regulations had been amended * * * did Excella's right of election come into being" (*ibid.*) is, of course, quite accurate, but it has nothing to do with this case where the "right of election" was admittedly "in being" all of the time.

Circuit is in accord with the only other decision squarely in point, *i. e.*, the recent ruling of the Court of Claims in *Kaufmann & Baer Co.* v. *United States*, 137 F. Supp. 725, certiorari denied, 352 U. S. 835. There, as here, a retail method taxpayer wished to adopt LIFO for its fiscal year 1942, but failed to file an election to do so prior to March 10, 1943, as required by § 19.22(d)–3. It did file an attempted election in April, 1943. The Court of Claims held that the attempted election was not timely under the regulations, and hence found it unnecessary to decide the other issue presented, *i. e.*, whether the taxpayer had effectively revoked the election prior to the litigation.

By contrast, none of the three cases relied on by petitioners is in point. *Pictorial Review Co.* v. *Helvering*, 68 F. 2d 766 (C. A. D. C.), has already been distinguished and, to the extent that it is relevant, supports rather than conflicts with the decision below. *Manhattan Co.* v. *Commissioner*, 297 U. S. 129, has no conceivable relevance to this case: it held that a regulation which was contrary to the statute was null and void and that a subsequent valid regulation could be applied just as though the earlier regulation had never existed.

The only case remotely in point is *Joseph Horne Co.* v. *United States*, 161 F. Supp. 580 (C. Cls.), but, as the opinion below denying rehearing on the basis of this alleged conflict abundantly demonstrates, that decision is in no way in conflict. The taxpayer there (who, unlike Macy, had made a timely election of

LIFO for 1942) was seeking to make a retroactive election to have the involuntary liquidation provisions of § 22 (d) (6) (A) of the Code applied to that year. The court held that the Commissioner had discretionary authority under that section to allow retroactive elections in the case of hardship and had abused that discretion. The only relevance of the LIFO regulations to that issue was the court's apparent view that the original regulations had not prescribed the procedures or standards to be followed by retail method taxpayers in using the LIFO method and that, partly for that reason, no "liquidation" was shown on the taxpayer's return until the Commissioner required it in 1948 to recompute its income for those years with departmental inventories and a different price index. Whether or not that decision was correct,* it was obviously not in conflict with the decision here, as, indeed, is shown by the court's failure to cite or question its own earlier decision in *Kaufmann [illegible] Co. v. United States, supra,* which was fully in accord with the decision in this case.

3. In attempting to demonstrate the importance of the question involved, and alleged inequities in the result reached by the Second Circuit, taxpayers have misconceived the facts. They say that "the Government has announced" the existence of claims, identical with the instant case, aggregating between $300,000,000 and one billion dollars (Pet. 12). This assertion is based upon a press release prepared by the former United States Attorney for the Southern District of

* But see note 6, *supra.*

New York (Pet. App. 89-90). So far as that release may be read as referring to pending claims, it is not accurate. The Internal Revenue Service advises that similar claims now actually pending aggregate only a small fraction of the amounts mentioned by the former United States Attorney. The aggregate amount of similar claims which may be filed in the future is, of course, purely conjectural, although Government estimates have run as high as the figures stated in the press release.

Taxpayers also err in stating that the vast majority of retail method taxpayers have been forced to litigate their right to elect LIFO, and that, if the instant decision stands, that right will be available to "but a handful" of such taxpayers (Pet. 13). Since 1948 the Government has recognized (pursuant to its acquiescence in *Hutzler Brothers Co.*) the right of all retail method taxpayers to make an election of LIFO for any current tax year by filing an election with their return for that year. It is only as to retroactive elections that the Commissioner insists that the cut-off date provided by § 19.22 (d)-3 is binding upon retail method taxpayers—just as it is upon all other taxpayers. As noted above, many retail method taxpayers did elect LIFO in compliance with the time requirements of § 19.22 (d)-3, and their right to use LIFO has not been disputed since 1948. Macy chose not to file a timely election and, as the Second Circuit held, it must abide by the consequences.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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OCTOBER 1958.

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

* * * * * * *

(c) *Inventories.*—Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

(d) [As amended by Sec. 219 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] (1) A taxpayer may use the following method (whether or not such method has been prescribed under subsection (c)) in inventorying goods specified in the application required under paragraph (2):

(A) Inventory them at cost;

(B) Treat those remaining on hand at the close of the taxable year as being: First, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof, and second, those acquired in the taxable year; and

(C) Treat those included in the opening inventory of the taxable year in which such method is first used as having been acquired at the same time and determine their cost by the average cost method.

(2) The method described in paragraph (1) may be used—

(A) Only in inventorying goods (required under subsection (c) to be inventoried) specified in an application to use such method filed at such time and in such manner as the Commissioner may prescribe; and

(B) [As amended by Sec. 118 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] Only if the taxpayer establishes to the satisfaction of the Commissioner that the taxpayer has used no procedure other than that specified in subparagraphs (B) and (C) of paragraph (1) in inventorying such goods to ascertain the income, profit, or loss of the first taxable year for which the method described in paragraph (1) is to be used, for the purpose of a report or statement covering such taxable year (i) to shareholders, partners, or other proprietors, or to beneficiaries, or (ii) for credit purposes.

(3) The change to, and the use of, such method shall be in accordance with such regulations as the Commissioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income.

(4) In determining income for the taxable year preceding the taxable year for which such method is first used, the closing inventory of such preceding year of the goods specified in such application shall be at cost.

* * * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

Treasury Regulations 103, promulgated under the Internal Revenue Code of 1939:

SEC. 19.22 (c)-8. *Inventories of retail merchants.*—Retail merchants who employ what is known as the "retail method" of pricing inventories may make their returns upon that basis, provided (1) that the use of such method is designated upon the return, (2) that accurate accounts are kept, and (3) that such method is consistently adhered to unless a change is ap-

thorized by the Commissioner as provided in section 19.41–2. Under this method the total of the retail selling prices of the goods on hand at the end of the year in each department or of each class of goods is reduced to approximate cost by deducting therefrom an amount which bears the same ratio to such total as—

(a) the total of the retail selling prices of the goods included in the opening inventory plus the retail selling prices of the goods purchased during the year, with proper adjustment to such selling prices for all mark-ups and mark-downs,

less

(b) the cost of the goods included in the opening inventory plus the cost of the goods purchased during the year,

bears to (a).

This amount should represent as accurately as may be the amounts added to the cost price of the goods to cover selling and other expenses of doing business and for the margin of profit.

* * * * *

SEC. 19.22 (d)–1. *Inventories under elective method.*—Any taxpayer permitted or required to take inventories pursuant to the provisions of section 22 (c), and pursuant to the provisions of sections 19.22 (c)–1 to 19.22 (c)–8, inclusive, may elect with respect to those goods specified in his application and properly subject to inventory to compute his opening and closing inventories in accordance with the method provided by section 22 (d), as amended. Under this elective inventory method, the taxpayer is permitted to treat those goods remaining on hand at the close of the taxable year as being:

First, those included in the opening inventory of the taxable year, in the order of acquisition and to the extent thereof, and

Second, those acquired during the taxable year.

This elective inventory method is not dependent upon the character of the business in which the taxpayer is engaged, or upon the identity or want of identity through commingling of any of the goods on hand, and may be adopted by the taxpayer as of the close of any taxable year beginning after December 31, 1938.

* * * * *

SEC. 19.22 (d)–2 [As amended by T. D. 5163, 1942–2 Cum. Bull. 80, and T. D. 5199, 1942–2 Cum. Bull. 81]. *Requirements incident to adoption and use of elective method.*—The adoption and use of the elective inventory method is, by section 22 (d) and regulations thereunder, made subject to the following requirements:

(1) The taxpayer shall file an application to use such method, specifying with particularity the goods to which it is to be applied;

(2) The inventory shall be taken at cost regardless of market values;

(3) Goods of the specified type included in the opening inventory of the taxable year for which the method is first used shall be considered as having been acquired at the same time and at a unit cost equal to the actual cost of the aggregate divided by the number of units on hand. The actual cost of the aggregate shall be determined pursuant to the inventory method employed by the taxpayer under the regulations applicable to the preceding taxable year with the exception that restoration shall be made with respect to any write-down to market values resulting from the pricing of former inventories;

(4) Goods of the specified type on hand as of the close of the taxable year in excess of what were on hand as of the beginning of the taxable year shall be included in the closing inventory, regardless of identification with specific invoices, at costs determined as follows:

(a) By reference to the actual cost of the goods most recently purchased or produced;

(b) By reference to the actual cost of the goods purchased or produced during the taxable year in the order of acquisition;

(c) By application of an average unit cost equal to the aggregate cost of all of the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced, the goods reflected in such inventory increase being considered for the purposes of section 22 (d) as having been acquired all at the same time; or

(d) Pursuant to any other proper method which, in the opinion of the Commissioner, clearly reflects income.

Whichever of the several methods of valuing the inventory increase is adopted by the taxpayer and approved by the Commissioner shall be consistently adhered to in all subsequent taxable years so long as the elective inventory method is used by the taxpayer;

* * * * *

(5) The taxpayer shall establish to the satisfaction of the Commissioner that the taxpayer, in ascertaining income, profit, or loss for the taxable year for which the elective inventory method is first used or for any subsequent taxable year, for credit purposes or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries, has not used any inventory method other than that referred to in section 19.22 (d)–1 or at variance with the requirement referred to in paragraph (3) of this section, the taxpayer's use of market value in lieu of cost or his issuance of reports or credit statements covering a period of operations less than the whole of the taxable year not being considered at variance with this requirement;

(6) Goods of the specified type on hand as of the close of the taxable year preceding the taxable year for which this inventory method is first used, whether such preceding taxable year began before or after December 31, 1938, shall be included in the taxpayer's closing inventory for such preceding taxable year at cost determined in the manner prescribed in paragraph (3) of this section;

* * * * * *

SEC. 19.22 (d)-3 [As amended by T. D. 5199, *supra*]. *Time and manner of making election.*—The elective inventory method may be adopted and used only if the taxpayer files with his return for the taxable year as of the close of which the method is first to be used (or, if such return is filed prior to March 10, 1943, the ninetieth day after the approval of Treasury Decision 5199, then at any time prior to such date), in triplicate on Form 970 (revised), and pursuant to the instructions printed thereon and to the requirements of this section, a statement of his election to use such inventory method. Such statement shall be accompanied by an analysis of all inventories of the taxpayer as of the beginning and as of the end of the taxable year for which the elective method is proposed first to be used, and also as of the beginning of the preceding taxable year. In the case of a manufacturer, this analysis shall show in detail the manner in which costs are computed with respect to raw materials, goods in process, and finished goods, segregating the products (whether in process or finished goods) into natural groups on the basis of either (1) similarity in factory processes through which they pass, or (2) similarity of raw materials used, or (3) similarity in style, shape, or use of finished products. Each group of products shall be clearly described.

The taxpayer shall submit for the consideration of the Commissioner in connection with the taxpayer's adoption or use of the elective inventory method such other detailed information with respect to his business or accounting system as may be at any time requested by the Commissioner.

As a condition to the taxpayer's use of the elective inventory method, the Commissioner may require that the method be used with respect to goods other than those specified in the taxpayer's statement of election if, in the opinion of the Commissioner, the use of such method with respect to such other goods is essential to a clear reflection of income.

Whether or not the taxpayer's application for the adoption and use of the elective inventory method should be approved, and whether or not such method, once adopted, may be continued, and the propriety of all computations incidental to the use of such method will be determined by the Commissioner in connection with the examination of the taxpayer's returns.

Office-Supreme Court, U.S.
FILED
SEP 15 1958
JAMES R. BROWNING, Clerk

No. 369

IN THE

Supreme Court of the United States

October Term, 1958

R. H. MACY & CO., INC., L. BAMBERGER & CO., DAVISON-PAXON CO., and THE LASALLE & KOCH COMPANY,

Petitioners,

v.

UNITED STATES OF AMERICA.

PETITIONERS' APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

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Explanatory Note:

For the convenience of the Court, original Record pages are indicated in brackets in the materials contained in this Appendix, which are a part of the original Record certified to this Court.

Opinion Below

[67b] UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

———*———

No. 189—October Term, 1957.

(Argued March 10, 1958 Decided May 12, 1958.)

Docket No. 24710

———*———

R. H. MACY & CO., INC., L. BAMBERGER & CO., DAVISON-PAXSON CO., and THE LA SALLE & KOCH COMPANY,

Plaintiffs-Appellees,

—v.—

UNITED STATES OF AMERICA,

Defendant-Appellant.

———*———

Before:

CLARK, *Chief Judge,*
HINCKS, *Circuit Judge,* and BRENNAN, *District Judge.*

———*———

Appeal from the United States District Court for the Southern District of New York. Alexander Bicks, *Judge.*

Defendant, United States of America, appeals from a summary judgment, D. C. S. D. N. Y., 148 F. Supp. 377, for plaintiffs, R. H. Macy & Co., Inc., L. Bamberger & Co., Davison-Paxson Co., and The La Salle & Koch Company, in an action for the refund of income and excess profits taxes for the fiscal year 1942. Reversed and remanded for summary judgment for defendant.

Opinion Below

[68b] MORTON S. ROBSON, Asst. U. S. Atty., S. D. N. Y., New York City (Paul W. Williams, U. S. Atty., and Daniel F. McMahon, Asst. U. S. Atty., New York City, on the brief), *for defendant-appellant.*

ROSWELL MAGILL, of Cravath, Swaine & Moore, New York City (Albert Rosenblum, Charles T. Stewart, Nathan Dreizen, and George S. Parlin, Jr., on the brief), *for plaintiffs-appellees.*

———*———

CLARK, *Chief Judge*:

The defendant appeals from a summary judgment in favor of the taxpayer, Macy,[1] allowing it to recover income and excess profits taxes for the fiscal year 1942 and denying defendant's cross-motion for summary judgment. D. C. S. D. N. Y., 148 F. Supp. 377. The facts have been stipulated. At issue is whether Macy, in 1948, may recompute taxable income for the fiscal year 1942, using the "last-in, first-out" (LIFO) method of inventory, when it had failed to file an election to use that method within the time prescribed by the Commissioner of Internal Revenue.

In its operation of retail department stores Macy values inventories according to the retail method of inventory valuation which was, and still is, acceptable to the Treasury Department. Under this method, inventory records are maintained by each department in the store in terms of dollars, rather than in terms of specific articles of mer-

[1] R. H. Macy & Co., Inc., was the sole stockholder of L. Bamberger & Co., Davison-Paxon Co., and The La Salle & Koch Company. In 1948 these subsidiaries were liquidated, and their assets, including the tax refund claims here involved, were distributed to Macy, which hereinafter is treated as the sole plaintiff.

[69b] chandise.[2] Under any method of inventory, "costing" the closing inventory is a necessary step in the calculation of taxable income. FIFO and LIFO are alternative accounting methods for arriving at this cost. LIFO assumes that the last articles purchased during the year were the first ones sold, so that articles left in the inventory at the end of the year were the first ones purchased. FIFO (first in, first out) assumes the converse, that the earliest article purchased was the first one sold, so that articles left in the inventory at the end of the year were the last ones purchased. Obviously neither FIFO nor LIFO corresponds with actual fact, although the FIFO assumption seems more logical in the normal course of business operations. In a period of stable prices the application of either theory renders the same result. But during an inflationary period, LIFO is distinctly advantageous to the taxpayer, for, in effect, he is not required to include as profit increases in value of inventory. This illustrates the real purpose of the methods—to reflect accurately what normally is considered as profit during inflationary and deflationary periods in the economy.

Prior to 1939 only a limited class of taxpayers were permitted to use the LIFO method in calculating their federal taxes. The Internal Revenue Code of 1939, § 22(d), however, provided for its use by any taxpayer who complied with the requirements of the section. Two such requirements are at issue here: One, contained in § 22(d)(2)(A), required the taxpayer to make a binding application to use the LIFO method to be filed in a manner and at a time prescribed by the Commissioner. The other, contained in § 22(d)(3), required that the use of LIFO be in accordance

[2] For a detailed exposition of the "retail method," see *Hutzler Bros. Co.* v. *C. I. R.*, 8 T. C. 14, 15, 16.

with regulations which the Commissioner could prescribe as [70b] necessary so that the use of the method would clearly reflect income. The Commissioner implemented the statute with Regulations 103, § 19.22(d). This required that the taxpayer file a statement of election to use LIFO with his return for the taxable year in which the method was first to be used, thus following the direction of § 22(d)(2)(A). And it further elaborated on other portions of the statute by spelling out with greater specificity the statutory requirements incident to the use of LIFO.

Macy's directors decided to adopt the LIFO method and took many of the necessary steps to implement their decision. Its executive committee voted to adopt the method for the purpose of determining operating profit to be shown in its annual report, and its board of directors followed suit soon thereafter. In addition Macy kept its regular books of account for the fiscal year 1942 on a LIFO basis and in a prospectus relating to an issue of debentures it used LIFO to compute earnings for that fiscal year. Thus it seems apparent that Macy seriously was considering a change over to LIFO in its return for the fiscal year 1942 which was filed in July of that year.

Two factors, however, complicated the effectuating of this decision. First, Macy had issued during the fiscal year of 1942 an interim report which was not based on LIFO. As the statute existed prior to its amendment in October 1942, this barred Macy from using LIFO for that fiscal year. Second, as stipulated by the parties, the Commissioner and other representatives of the Treasury Department took the position that LIFO was not available to users of the retail method of inventory valuation, since such taxpayers determined their inventories in terms of dollar values, rather than in terms of specific goods. Evidently the Com-

missioner interpreted the language of the statute which permitted the use of LIFO in inventorying "goods" to pre-
[71b] clude its use by taxpayers who inventoried in terms of dollars. The argument is based on the fact that FIFO and LIFO deal in terms of specific articles of merchandise and thus appear to be inapposite to the retail method of inventory valuation, which deals in terms of dollar values. But this seeming inappropriateness is superficial when one considers the purpose of the theories—accurate reflection of profit—and essentially it is simple to apply the FIFO or LIFO assumptions to retail-method taxpayers. In the case of LIFO this consists roughly of adjusting the value of the closing inventory by price indices which reflect increases in value during the year.[3] These difficulties did not completely discourage Macy, however, for in its return for that fiscal year, which was timely filed on July 15, 1942, inventories were reported on the basis of LIFO, using retail price indices prepared by the National Industrial Conference Board. Macy adjusted the income and excess profits taxes due, however, so as to reflect the retail method of inventory valuation, without the application of LIFO, and paid its taxes on this basis. Thus Macy filed a "dual" return which reflected taxable income with and without the use of LIFO, but actually paid its taxes without using the theory.

The Internal Revenue Code of 1939 was amended the following October to remove the first difficulty. The regulations were amended in December to allow taxpayers previously barred from using LIFO because of their publication of inconsistent interim reports to elect LIFO for the

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[3] A method for making the adjustments once the proper indices are determined is illustrated in *Hutzler Bros. Co.* v. *C. I. R.*, 8 T. C. 14. See also *Edgar A. Basse* v. *C. I. R.*, 10 T. C. 328.

barred years by filing Treasury Department Form 970 prior to March 10, 1943. Macy was now in a position to effectuate its decision to adopt the LIFO method for the fiscal [72b] year 1942. But March 10, 1943, came and went without Macy filing the required notice of election, allegedly because of the Commissioner's opposition, which at that time had never been the subject of a formal ruling or decision.

Some seventy other retailers refused to acquiesce in the Commissioner's informal position, however, and they filed statements of election to use the LIFO method. In the absence of published price indices to adjust closing inventories, so as to make possible the computation of that portion of profit which was due to the year's price rise, these retailers used indices prepared by the National Industrial Conference Board, as had Macy in its original return for the fiscal year 1942. The Commissioner then took a formal stand disallowing the use of LIFO by "retail method" taxpayers. The issue came to a head in 1947 when the Tax Court in *Hutzler Bros. Co.* v. *C. I. R.*, 8 T. C. 14, 28, decided in favor of the taxpayer and held that the statute contemplated the use of LIFO by taxpayers who valued inventory according to the retail method. The court interpreted the word "goods" as used in §§ 22(d)(1) and (2) broadly as merchandise "describing in the generic sense the stock in trade of a typical department store." The court also held that, regardless of the Commissioner's position, his "regulations are as consistent with petitioner's position as they are with that of respondent." *Ibid.* This statement obviously was directed at § 19.22(d)-2 of the regulation which referred to "goods" to be inventoried. The court suggested, however, that the Commissioner issue new regulations consistent with its opinion. The Commissioner acquiesced in

the decision and, possibly because of the court's suggestion, issued amendments to the regulations. The major change by way of amendment was to add information concerning acceptable price indices. In addition the amendments removed any question as to the applicability of § 19.22(d)-2 [73b] to retail method taxpayers. The amendments were retroactive to all taxable years beginning after December 31, 1938. Shortly thereafter the Commissioner issued Mim. 6244, 1948-1 C. B. 21, stating in detail proper price indices and providing that retailers who previously had filed returns on the basis of LIFO using unacceptable indices could thereafter file amended returns for all "open" years based on indices acceptable to the Commissioner.

In September or October 1948, Macy filed notices of election to use LIFO for the fiscal year 1942, together with claims for refund of taxes paid for that year. In 1948 this year was still an "open" year for purposes of claiming refunds. In early 1951 Macy requested a ruling on its election and claim. Eventually, in 1954, the Commissioner ruled adversely to it on the ground that it had failed to file a notice of election to use LIFO for the fiscal year 1942 on or before March 10, 1943, as required by the regulation.

Macy contends that it was not required to file an election on that date, because the whole regulation which the Commissioner issued to govern the use of LIFO was inapplicable to it, a taxpayer using the retail method of inventory valuation. Both Macy and the government agree that the statutory right to elect LIFO was not absolute, but was conditioned upon compliance with appropriate regulations to be issued by the Commissioner pursuant to §§ 22(d)(2)(A) and (3). There is little argument with respect to the regulation designed to implement § 22(d)(2)(A), for it clearly sets forth the time and manner of filing applications to use LIFO. But Macy points to § 22(d)(3)

of the Act, which provides that "[t]he change to, and the use of, [the LIFO] method shall be in accordance with such regulations as the Commissioner * * * may prescribe as necessary in order that the use of such method may clearly reflect income." It then contends that § 19.22(d)-2 of the [74b] regulation, which purportedly was issued to implement § 22(d)(3), did not permit the inventorying of goods by departments or classes or provide price indices to convert the retail method inventory figure to a LIFO figure, and thus prohibited LIFO to taxpayers who used the retail method of inventory valuation. Therefore it claims that as the regulations relating to the change to, and the use of, LIFO were not applicable to it, the regulations relating to time and manner of election were likewise inapplicable until 1948 when they were amended.

Macy's conclusion does not withstand a careful analysis of the statute and the regulations. First, Regulations 103, § 19.22(d)-1 specifically provided that "[a]ny taxpayer permitted or required to take inventories pursuant to the provisions of Section 22(c) and pursuant to the provisions of Sections 19.22(c)-1 to 19.22(c)-8, inclusive, may elect with respect to those goods specified in his application and properly subject to inventory to compute his opening and closing inventories in accordance with the method provided by Section 22(d) [the LIFO method]." Section 19.22(c)-8 of the regulations, referred to above, permitted retail merchants to employ the retail method. Thus the LIFO regulations specifically stated that taxpayers like Macy could use the LIFO method to compute opening and closing inventories.

Second, at least two other courts have held that the LIFO regulations were applicable to "retail method" tax payers. In *Hutzler Bros. Co.* v. *C. I. R.*, *supra*, 8 T. C. 14,

the Commissioner argued that his interpretive regulations showed the statute did not permit the use of LIFO by a taxpayer like Macy and in fact barred such use. But the Tax Court rejected this argument and held that the regulations were "ambiguous and largely irrelevant administrative interpretations" of the statute and that they supported the [75b] taxpayer's contentions as much as those of the Commissioner. 8 T. C. 14, 28. And this is a logical result, for initially the Commissioner believed that the words of the statute made it inapplicable to taxpayers who used the retail method of inventory valuation. Therefore he cast his regulations in the same words which ultimately were held to allow use of LIFO by such taxpayers. When the court rejected the Commissioner's interpretation of the statute it simultaneously rejected his interpretation of similar words used in his regulation which rendered it no bar to the use of LIFO by "retail method" taxpayers.[4]

In the other case, *Kaufman & Baer Co.* v. *United States*, 133 Ct. Cl. 510, 137 F. Supp. 725, certiorari denied 352 U. S. 835, a plaintiff, which used the retail method of inventory valuation, filed its federal tax return for the fiscal year 1942 on the basis of FIFO. It later filed an election to use LIFO for that fiscal year, as permitted by the amendment to § 22(d), which removed the prohibition contained

[4]Macy contends that requirements contained in § 19.22(d)-2 of the regulations were inapposite to the retail method of inventory valuation and in effect prohibited it from using LIFO. The section required the filing of an application "specifying with particularity the goods to which it [LIFO] is to be applied," and provided that goods included in the opening inventory "shall be considered as having been acquired at the same time and at a unit cost equal to the actual cost of the aggregate divided by the number of units on hand." The short answer to Macy's argument is that the statute, § 22(d), which the Tax Court held applicable to "retail method" taxpayers, used similar language. See especially §§ 22(d)(1) and (2). Certainly Macy does not argue that this statutory language prohibits its use of LIFO.

in the original statute against the adoption of LIFO for a year during which a taxpayer issued interim reports on a non-LIFO basis. But it filed its election late—nearly a month after the cut-off date set out in the LIFO regulation. A claim for refund accompanied the election. Shortly afterwards plaintiff wrote to the Commissioner and indicated its desire to withdraw the election and the claim for refund. [76b] As now, the statute and the regulations permitted revocation of an election to use LIFO only with the approval of the Commissioner. The Commissioner, without referring to the purported revocation, denied the claim for refund. The plaintiff, treating its revocation as a nullity (because it did not have the Commissioner's approval), later commenced an action to recover the refund due upon its recalculation of taxes for the fiscal year 1942, using LIFO, rather than FIFO. The court found it unnecessary to decide whether plaintiff's attempt to revoke was effective, for it specifically held that in any case plaintiff's election was not timely made. Thus the court necessarily held that the regulations were applicable to a "retail method" taxpayer. The learned trial judge in the case at bar was in error in labeling this holding "*obiter dicta.*"

Third, a regulation setting forth acceptable price indices to enable Macy to convert closing inventories to LIFO was unnecessary under the statute. Section 22(d)(3) permitted but did not require the Commissioner to issue regulations governing the change to, and use of, LIFO so that its use would clearly reflect income. Thus the Commissioner was under no duty to issue a specific regulation prescribing the accounting methods to be used by "retail method" taxpayers to enable them to adopt LIFO. In the absence of such a regulation these taxpayers were free to adopt any method which they believed proper, subject of course to the Commissioner's approval. Certainly Macy was not prejudiced

by this procedure, for it, together with other retailers, had price indices prepared by the National Industrial Conference Board which it used for its annual report. And these same indices were used by Hutzler Brothers Company in its return for the fiscal year 1942. The fact that the Commissioner only in 1948 came to issue information concern- [77b] ing acceptable indices is of no moment. He had the discretion to do this at any time he chose.

Ultimately Macy's argument is that it failed to file a timely election because the Commissioner maintained the position that LIFO was not available to users of the "retail method." Although this argument evokes a certain sympathy it is unavailing as an excuse for Macy's delinquency. As Judge Littleton said in *Kaufman & Baer Co.* v. *United States, supra*, 133 Ct. Cl. 510, 137 F. Supp. 725, 730, certiorari denied 352 U. S. 835: "The Commissioner's interpretation of the applicable sections to mean that retailers using dollar totals rather than specific items could not use the LIFO method was erroneous. If the plaintiff wanted to use the LIFO method it should have filed its returns on that basis and have made a timely election to use the method, as did other taxpayers. The Commissioner's failure to act on the election to use LIFO did not prejudice plaintiff. It could have sought action by the Commissioner or from the courts if it desired." Hutzler Brothers Company and some seventy other similarly situated taxpayers took the necessary steps and ultimately succeeded. They were bound by their 1942 elections to use LIFO thereafter, while Macy, if it were successful here, would have had the benefit of six years' hindsight in deciding whether or not to elect LIFO for the fiscal year 1942.

In summary, Macy, if it chose to avail itself of the LIFO method for the fiscal year 1942, had to file its application

at the time and in the manner prescribed by the Commissioner. His valid and applicable regulation required an election on or before March 10, 1943. Macy failed to meet this requirement. It is no excuse that this failure occurred because the Commissioner opposed Macy's exercise of its statutory right or a succeeding Commissioner erroneously considered the excuse valid. Not thus is the United States [78b] of America to be estopped in the collection of its revenue. *Automobile Club of Michigan* v. *C. I. R.*, 353 U. S. 180, 183-184. Accordingly the lower court erred in awarding summary judgment to Macy.

Reversed and remanded for summary judgment for defendant.

Judgment Below

[79b] UNITED STATES COURT OF APPEALS

FOR THE

SECOND CIRCUIT

———*———

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 12th day of May one thousand nine hundred and fifty-eight.

Present:

HON. CHARLES E. CLARK,
Chief Judge
HON. CARROLL C. HINCKS
HON. STEPHEN W. BRENNAN,
District Judge

R. H. MACY & COMPANY, INC.,
BAMBERGER & COMPANY, *et al.*,
Plaintiffs-Appellees,

—v—

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed and action remanded for summary judgment for defendant, in accordance with the opinion of this court.

A. DANIEL FUSARO,
Clerk

Opinion Below Denying Rehearing

[129b]

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 189—October Term, 1957.

(Petition filed May 27, 1958 Decided June 16, 1958.)

Docket No. 24710

R. H. MACY & CO., INC., L. BAMBERGER & CO., DAVISON-PAXON CO., and THE LA SALLE & KOCH COMPANY,
Plaintiffs-Appellees,

—v.—

UNITED STATES OF AMERICA,
Defendant-Appellant.

Before:

CLARK, *Chief Judge,*
HINCKS, *Circuit Judge,* and BRENNAN, *District Judge.*

On Petition for Rehearing.

CRAVATH, SWAINE & MOORE, New York City (Roswell Magill, George G. Tyler, Nathan Driezen, Charles T. Stewart, Edward O. Carr, Jr., George S. Parlin, Jr., and Albert Rosenblum, of counsel), *for plaintiffs-appellees.*

CLARK, *Chief Judge:*

Plaintiffs-appellees urge as a basis for rehearing of our reversal of the judgment below in their favor that the recent

[130b] decision of the Court of Claims in *Joseph Horne Co.* v. *United States*, Ct. Cl., May 7, 1958, is in conflict with our disposition of this case in that it implicitly rejects the prior decision of that court in *Kaufmann & Baer Co.* v. *United States*, 133 Ct. Cl. 510, 137 F. Supp. 725, certiorari denied 352 U. S. 835, which we cited as holding that the pre-1948 LIFO regulations were applicable to "retail method" taxpayers. But a careful consideration of the cited case convinces us that this contention is without merit. There is nothing to suggest that the court there thought it was overruling its earlier decision, which is not even cited in either the prevailing or the dissenting opinion. Actually this late case deals with a different statutory provision and a different situation—that of "involuntary liquidation"—than our present issue. Concededly it can be applicable only by a process of reasoning by implication and analogy which we find unpersuasive.

The issue in the *Horne* case was whether Congress intended, in passing in 1950 as an amendment to I. R. C. 1939, § 22(d)(6)(A), 64 Stat. 592, Pub. L. 756, 81st Cong., 2d Sess. (1950), to allow taxpayers like Horne the use of the involuntary liquidation provisions therein contained for tax years prior to 1948. Neither the Public Law nor § 22(d)(6)(A) is applicable to the problems raised in this case, which are governed by I. R. C. 1939, § 22(d)(2) and (3). The provisions involved in the *Horne* case were for the benefit of LIFO users; and Horne, unlike Macy, filed a timely election to use LIFO in 1942 and filed its returns for the years in question on that basis. It failed, however, to file the required elections to invoke the involuntary liquidation privileges because the system of indices that it used to convert its inventories to LIFO (storewide indices) did not disclose the so-called involuntary liquidations. When in 1948 the Commissioner of Internal Revenue

published acceptable indices (based on departmental, rather [131b] than storewide, experience) Horne recalculated its prior conversions and discovered involuntary liquidations in certain departments which it then wished to utilize for their tax benefits. It was foreclosed from doing this because of its failure to make timely elections in the past. Congress then passed 64 Stat. 592, and the Court of Claims held that by it Congress intended to provided relief for taxpayers like Horne which did file timely elections to use LIFO, but computed inventories on other than the acceptable departmental bases.

Macy argues that Horne could not have prevailed in the Court of Claims unless the pre-1948 regulations were inapplicable to "retail method" taxpayers. It seems to be saying that if the regulations applied, Horne had to comply with them by filing inventories using departmental price indices which would have disclosed involuntary liquidations. Obviously, however, prior to 1948 the Commissioner, in his discretion, had issued no regulations stating acceptable indices. Therefore prior to 1948 Horne could use any method subject to the Commissioner's approval, and storewide indices were conditionally acceptable. Thus Horne's proper compliance with applicable regulations did not show involuntary liquidations. So the Court of Claims decided that Congress intended to give relief to taxpayers who otherwise would be harmed by the Commissioner's failure to publish acceptable indices sooner. Its conclusion is not at all inconsistent with its holding in the *Kaufman & Baer Co.* case that the LIFO regulations were applicable (as far as they went) to retail method taxpayers prior to 1948; nor is it inconsistent with our disposition of the present appeal. The other points raised in the petition for rehearing were previously considered and rejected by us.

Petition denied.

Order Below Denying Rehearing

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the sixteenth day of June, one thousand nine hundred and fifty-eight.

Present:

HON. CHARLES E. CLARK,
Chief Judge,

HON. CARROLL C. HINCKS,
Circuit Judge,

HON. STEPHEN W. BRENNAN,
District Judge

R. H. MACY & CO., INC., L. BAMBERGER & CO., DAVISON-PAXON CO., and THE LASALLE & KOCH COMPANY,
Plaintiffs-Appellees,
v.
UNITED STATES OF AMERICA,
Defendant-Appellant.

A petition for a rehearing having been filed herein by counsel for the appellees,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

[32a] **Opinion of the District Court**

(87)

[SAME TITLE]

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OPINION

BICKS, *D. J.*

In this action for refund of Federal income (88) tax and declared value excess profits tax[1] for the fiscal year [33a] ended January 31, 1942, plaintiffs have moved for summary judgment and the defendant has cross moved for

[1]The complaint seeks a refund in the aggregate amount of $727,523.46. The parties have stipulated, however, that the exact amount will be computed subsequent to the decision on the merits

similar relief. The determinative facts having been in the main stipulated, the decision turns upon the construction and applicability of the Regulations promulgated by the Commissioner of Internal Revenue under Section 22(d) of the Internal Revenue Code of 1939.

The plaintiffs[2] (hereinafter referred to as Macy) owned and operated large retail department stores. For many years prior to the fiscal year ended January 31, 1942 Macy employed the so-called retail method of pricing or (89) evaluating its inventories; a method approved[3] by the Treasury Department and in general usage by department store operators. Under that method inventories are taken in terms of selling price dollar values rather than by specific items of merchandise with the consequence that goods in a single department are treated for inventory purposes as being entirely fungible, although in fact they may, and generally do, differ considerably as to type, [34a] quality, and price.[4] In costing a closing inventory it becomes necessary to resort to an assumption as to what goods with what costs have been sold during the year and

[2]R. H. Macy & Co. Inc. was the sole stockholder of plaintiffs L. Bamberger & Co., a New Jersey corporation, Davison-Paxon Co., a Georgia corporation and The LaSalle & Koch Company, an Ohio corporation. On January 31, 1948 the subsidiary corporations were completely liquidated, and their property and assets, including the tax refund claims involved in this suit, were distributed to Macy in complete cancelation and redemption of all of its stock in each of said subsidiaries. Although under the law of its state of incorporation the corporate existence of each of said subsidiaries has continued to date for the purpose of suing and being sued, the parties have stipulated that in the event it is held the plaintiffs are entitled to refunds, judgment for the entire amount thereof may be entered in favor of Macy on its own behalf and as successor of said subsidiary corporations.

[3]I.D. 3058, 3 C.B. 72, (1920); Regulations 111, sec. 29.22 (c)-8.

[4]For a review of the characteristics of the retail method see *Hutzler Brothers Company v. Commissioner of Internal Revenue*, 8 T. C. 14 (1947).

what goods with what costs remain on hand. One of two assumptions might be used: (1) that an article of merchandise "first in", *i.e.*, the article purchased earliest, was the first one sold and that the articles left in the inventory at the end of the year were purchased last, the so-called FIFO method; or (2) that an article of merchandise "last in", *i.e.*, the article last purchased, was the first sold and that the articles left in the closing inventory were the articles first purchased, the so-called LIFO method. Neither assumption can be entirely true; but it is essential to use one or the other (90) as the basis for the retail method.[5]

As long as the price structure remains relatively stable the FIFO method gives satisfactory results. In an era of inflation the method of inventory valuation looms importantly in determining taxable income. During such a period, the cost of goods sold, if values as reflected in the opening inventory are employed, will be lower and the gross profit on sales greater than would be the case if the cost of goods sold were determined under the LIFO method. Under FIFO, in periods of rising prices, taxable income may include profits that result merely from the increase in the value of the inventory on hand; whereas under LIFO such book profits are excluded. Increase in corporate tax rates, the steadily increasing rise in prices and the depreciating value of currency that accompanied the dis- [35a] turbed conditions in Europe immediately preceding World War II underscored the importance of this problem. The Congress recognized it by granting taxpayers permission to elect to use the LIFO method. As first enacted[6] permission to use the elective method was confined to taxpayers in certain industries, *e.g.*,

[5]The need to indulge in either of these assumptions exists generally—though not universally; it is not confined to taxpayers who use the retail method of inventory valuation.

[6]Revenue Act of 1938, § 22(d), 52 Stat. 459 (1938).

(91) producers and processors of certain non-ferrous metals and tanners of hides and skins.[7] In 1939 this permission was extended to all taxpayers.[8] Section 22(d) of the Revenue Act of 1939, so far as here pertinent, provides as follows:

> (d) METHOD OF INVENTORYING GOODS. (1) A taxpayer may use the following method [*i.e.*, the elective method] in inventorying goods specified in the application required under paragraph (2): (A) *** (B) *** (C) ***
>
> (2) The method described in paragraph (1) may be used—
>
> (A) Only in inventorying goods * * * specified in an application to use such method filed at such time and in such manner as the Commissioner may prescribe; and
>
> (B) Only if the taxpayer establishes to the satisfaction of the Commissioner that the taxpayer has used no procedure other than that [36a] specified in * * * paragraph (1) in inventorying (to ascertain income, profit, or loss, for credit purposes, or for the purpose of reports to shareholders, partners, or other proprietors, or to (92) beneficiaries) such goods for any period beginning with or during the first taxable year for which the method described in paragraph (1) is to be used.
>
> (3) The change to, and the use of, such method shall be in accordance with such regulations as the Com-

[7] It is demonstrable that this was intended as an ameliorative measure rather than as an aid for accurate ascertainment of the date of purchase of the goods in the closing inventory. For example, in industries where the prime raw material is leather requiring processing, it is a physical impossibility for the raw leather last in to be the first out.

[8] Revenue Act of 1939, § 22(d), 53 Stat. 11 (1939).

missioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income.

The provision in subdivision (2)(B), precluding the use of the elective method by a taxpayer who *during* the first taxable year for which it is sought to be used employed some other method "* * * for the purpose of reports to shareholders * * *", was amended in 1942[9] retroactively to taxable years beginning after December 31, 1938, to interdict the use of the elective method by taxpayers who used some method other than LIFO "* * * for the purpose of a report or statement *covering* such taxable year". The effect of the amendment was to make the elective method available notwithstanding the issuance of an interim report prepared on another basis.

In December 1939 the Commissioner of Internal Revenue promulgated Regulations pursuant to Section 22(d). From almost the very outset and until 1948 he and other representatives (93) of the Treasury Department and the Bureau of Internal Revenue took the position that the statutory grant of leave to use the LIFO method was not [37a] applicable to users of the retail method. The Commissioner's rationale, as stipulated by the parties, was that since users of the retail method determined their inventories in terms of dollar values rather than in terms of specific goods[10] the specificity of the inventoried goods required by Section 22(d) I. R. C. was lacking. Accordingly, in view of the then thinking of the Commissioner and other

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[9]Revenue Act of 1942, § 118, 56 Stat. 814 (1942).

[10]It has been stipulated that due to the multiplicity of items carried by retail department stores and the varying price ranges of those items, it is not practicable to account for the inventories of those stores on an item basis.

representatives of the Treasury Department,[11] the Regulations did not make the necessary provisions to permit application of LIFO to users of retail method.[12]

(94)

In 1942 Macy and other retailers, as well as representatives of the National Retail Dry Goods Association, held conferences with representatives of the Treasury Department and the Bureau of Internal Revenue for the purpose, among others, of persuading those agencies to abandon their position that users of the retail method did not fall within the class of taxpayers qualified to adopt the elective method. In anticipation that their efforts would meet with success, the Macy management decided to adopt [38a] LIFO for the purpose of its Annual Report to its Stockholders for the fiscal year ended January 31, 1942.[13]

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[11] "* * * many taxpayers are unable to use the last-in first-out method, particularly taxpayers whose inventory consists of a large number of different products rather than a few homogeneous products," Statement on June 15, 1942 by Randolph E. Paul, tax advisor to the Secretary of the Treasury before the House Ways and Means Committee.

[12] "Until after the decision in *Hutzler Brothers Co.* v. *Commissioner*, 8 T. C. 14, the Commissioner had issued no regulations with respect to the computation under the 'LIFO' method by a taxpayer using the retail inventory method." *Louis Pizitz Dry Goods Co.* v. *Deal et al.*, 208 F. 2d 724, 727 (5th Cir. 1953).

[13] In said Annual Report Macy advised its stockholders: "Your Corporation has decided to adopt for book purposes the so-called LIFO (last-in first-out) method of inventory valuation. The adoption of this method will serve to reduce in some measure distortion of annual earnings due to appreciation and depreciation in inventory values during a period of extensive changes in price levels. Our previous method of valuing inventories was 'cost or market, whichever is lower' as determined by the retail method. Under our present practice the LIFO method has been used to determine cost * * * Under existing provisions of the federal tax laws, the LIFO method may not be used by these companies for tax purposes, but it is believed that retroactive legislation will be enacted permitting its use for the year covered by this report."

For the purposes of said Report the opening inventories were arrived at by use of the retail method and the LIFO adjustments in connection with the closing inventories were based upon an index of retail price changes prepared by the National Industrial Conference Board. Plaintiff's regular books of account were kept on the same basis. The taxes shown on its tentative United States Income and (95) Declared Value Excess Profits Tax Returns for such fiscal year which were filed in April 1942 likewise were computed on the LIFO method. The final returns, timely filed in July 1942,[14] were prepared under the LIFO method, but the taxable incomes shown thereon were adjusted to what they would have been had the inventories been valued according to the retail method without the [39a] application of LIFO thereto.[15] By so doing Macy did not abandon its resolve to adopt LIFO. Its every act evidences the contrary. Witness: the numerous conferences with highly placed representatives of the Treasury Department and Bureau of Internal Revenue;[16] the (96) action of the Macy Executive Committee[17] and of the Macy Board

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[14]Several extensions of time were obtained in the expectation that in the intervening period either the Commissioner would recede from his position or amendatory legislation would be enacted granting relief to retailers.

[15]In the returns as filed the inventories were reported on the LIFO basis. Additions to taxable income attributable to the valuation of inventories on the FIFO method rather than on the LIFO method were made by appropriate adjustments in other sections of the returns.

[16]Such conferences were held on February 17, March 19, April 6, 7, 14, June 4 and July 20, 1942. At each of them the Macy representatives urged the Government representatives, *inter alia*, to abandon their opposition to the use of LIFO by users of the retail method.

[17]"LIFO—a method of evaluating merchandise inventories (Last-in First-out) was discussed and it was decided to adopt this method for the purpose of determining the operating profit to be reflected in the Stockholders Annual Report for the year

of Directors;[18] and the use of the LIFO method in computing its earnings for the purpose of the prospectus dated May 25, 1942 relating to a $12,000,000. [40a] issue of (97) 2½% Sinking Fund Debentures.[19] Furthermore, when the (98) final returns were filed Macy was ineligible to adopt the elective method of inventory valuation since it had issued a semi-annual report to stockholders during the fiscal year 1942 on the old basis. As already indicated the Regulations were amended in December 1942 removing this disqualification. However, the amended Regulations again failed to make any provision for adjustment to the LIFO basis of inventories taken on the retail method.

The Commissioner persisted in his position adverse to the views urged upon him by Macy and other retailers until the Tax Court of the United States decided in

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1941. However with respect to the Federal Income Taxes, it was decided to ask for a sixty-day extension, and if need be for a second sixty-day extension, so that we would be able to study the new tax law before filing a final Federal Income Tax return." Extract from minutes of a meeting of the Executive Committee, held on March 20, 1942.

[18] "The Treasurer reported that, after full consideration of the matter, the Executive Committee at its meeting on March 20, 1942, had decided to recommend that the so-called 'LIFO' (Last-in First-out) method of valuing inventories of the Corporation and its subsidiaries be adopted for purposes of the Annual Report to stockholders for the fiscal year ended January 31, 1942; and that decision as to the method of valuing inventories for tax purposes for that year be deferred pending further study of the matter in the light of possible amendments to the tax laws relative thereto." Extract from minutes of meeting of Board of Directors held on March 25, 1942.

[19] Note (D) to the Consolidated Profit and Loss Statement contained in said Prospectus in part states: "Under the present federal tax law and regulations issued thereunder, a taxpayer may use the Lifo method of inventory to determine taxable income if such taxpayer has used no other inventory method for certain purposes, including reports to stockholders, during the year for which the Lifo method is to be adopted. As the Corporation has issued a semi-annual report

[41a] *Hutzler*[20] that adaptation of the LIFO theory to inventories maintained in terms of dollars was permissible and proper within the provisions of Section 22(d) of the

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to stockholders for the six months ended August 2, 1941 on the old basis, it is prevented from using the Lifo method in the determination of taxable income for the year ended January 31, 1942. However, on March 4, 1942 Mr. Randolph Paul, Tax Advisor of the Secretary of the Treasury, in testifying before the Ways and Means Committee of the House of Representatives, stated that 'as the interim report requirement serves no real purpose and operates to discriminate unfairly between taxpayers who follow the practice of issuing interim reports and those who do not, it is suggested that the requirement be eliminated, and that the elimination be made retroactive to 1941.'

"Even if this provision relating to semi-annual reports is eliminated retroactively, two further factors must be considered in connection with the adoption of the Lifo method for tax purposes, as follows: (1) It is not clear whether the present tax law permitting the use of the Lifo method of inventory requires specific identification of goods in inventory and, if so, whether retailers carrying a large number of varying types of merchandise could meet that requirement. (2) Under the present law the adoption of the Lifo method would limit these companies to the use of 'cost' and would deprive them of the right to use 'cost' or market, whichever lower' which they have used for a long period of years.

"Convinced that the important test for the application of the Lifo method of inventory is investment in inventory rather than a particular method of bookkeeping, these companies have joined with others in the retailing industry in an effort to obtain retroactive legislation which would clarify the first of the above factors and obviate the second, in the following manner: (1) By specifically providing that, in determining cost, taxpayers with inventories of varying character and quality, impractical to identify, state, or reduce to common physical units, may state such inventories under the Lifo method on the basis of dollar investment adjusted for variations in price levels. (2) By allowing the use of 'cost or market, whichever lower' under the Lifo method, just as it is now allowed under the present retail method of inventory, as the Lifo method is merely another method of determining cost.

"Conferences have been held with representatives of the Treasury Department in an endeavor to obtain their recommendation that Congress enact the desired remedial legislation of a retroactive character. These discussions are continuing."

[20] 8 T. C. 14 (1947).

Internal Revenue Code. Thereafter on March 4, 1948, the Commissioner amended the regulations retroactively to all taxable years beginning after December 31, 1938 "* * * in order to adapt the retail inventory requirements of the regulations to the elective inventory principle of Section 22(d) of the Internal Revenue Code as enunciated by the Tax Court of the United States in * * *" the *Hutzler* case. T. D. 5605, 1948—1 C. B. 16, 17. There then appeared for the first time authorized statistical price indices for use by retailers such as Macy in adjusting (99) inventories taken on the retail method to the LIFO method. I. T. 3904, 1948—1 C. B. 18.

After promulgation of the amended regulations, Macy, [42a] in October 1948, filed claims for refund[21] of so much of the income tax and declared value excess profits tax it paid for the fiscal year 1942 as resulted from the Commissioner's failure and refusal to make the use of LIFO available to it.[22] Together with each such claim Macy filed an application for the adoption and use of the elective inventory method on the form provided for that purpose by the Treasury Department (Form 970).

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[21]The amended Regulations were, by their terms, made retroactively applicable to all taxable years beginning after December 31, 1938 that were not then barred by the applicable Statute of Limitations contained in Section 322(b) of the Code. In October 1948 Macy's fiscal 1942 was an open year.

[22]Another set of refund claims were filed by Macy on the ground that it was entitled, in valuing inventories for the fiscal year involved in this suit, to take into account the involuntary liquidation and replacement provision contained in Section 22(d)(6) of the Code. In view of the stipulation of the parties that if the Court finds there was a timely election of LIFO for tax purposes then there has also been a timely election under the involuntary liquidation provisions, the claims based on the latter provisions will not be treated separately.

Under date of January 15, 1951, Macy addressed a communication to the Commissioner in which rulings were requested to the effect that (i) if its refund claims for fiscal 1942 and subsequent years are finally disallowed, then it made an election to adopt LIFO for the fiscal year (100) ended January 31, 1948 and (ii) the granting of ruling (i) will not jeopardize the claims for refund for the earlier years. Macy received a reply from the Treasury Department dated January 31, 1951, signed "E. I. McLarney, Deputy Commissioner," stating in part that under even date the Internal Revenue Agent in Charge, Upper New York Division, New York, is being advised with respect to the position of the Commissioner "regarding your claims for refund filed upon the above-mentioned [43a] basis [use of the LIFO inventory method]. Accordingly, the requested rulings will not be issued at this time." The letter of even date from the Deputy Commissioner to the Internal Revenue Agent in charge recommended that Macy's right to use LIFO, beginning with the taxable year ended January 31, 1942, be recognized.[23] There then followed an audit of Macy's tax return for the 1942 fiscal year and a letter from the Internal Revenue (101) Agent

[23] The text of said letter in full is as follows: "Returned herewith are the files of the above-mentioned taxpayers for the taxable years ended January 31, 1943 to 1948, inclusive, and July 31, 1949, which were previously forwarded to this office at the request of Mr. C. W. Stowe, Assistant Deputy Commissioner. There also is enclosed the file for the taxable year ended January 31, 1941.

"With reference to the taxpayer's claims for refund, based upon the definitive steps taken in 1942 to adopt and use the Lifo inventory method, it is the opinion of this office that the taxpayer's failure to report taxable income on the basis of Lifo inventory values as reflected on its books was due to the Bureau's position of nonrecognition of the right to so report for Federal income tax purposes. Accordingly, the provisions of I.P.M. No. 448 are considered inapplicable to this case, and it is recommended that the taxpayer's right to use Lifo, beginning with the taxable year ended January 31, 1942, be recognized."

in Charge transmitting the audit report of the Revenue Agent. This report allowed Macy to use the LIFO method in computing its income tax and declared value excess profits tax and proposed appropriate over-assessments in favor of Macy.[24]

Despite the foregoing action by the Deputy Commissioner, the Internal Revenue Agent in charge and the Revenue Agent, the Commissioner of Internal Revenue in office in 1954, ruled that Macy had not met the require-
[44a] ments for adoption of the elective method and disallowed the claims for refund.[25] The requirements which Macy failed to meet were not indicated. It appears, however, that the Commissioner's sole reliance is upon the omission to file Form 970 with the 1942 return or prior to March 10, 1943. The issue narrows itself down, therefore, to whether such omission under the circumstances of this case, is fatal.
(102)

There is nothing explicitly in the Statute which requires such holding. Congress did not fix the time for filing the notice of election to adopt LIFO as it did with respect to the notice of election to apply the involuntary liquidation and replacement of inventory provisions of the same statute. See Section 22(d)(6)(A). It authorized the Commissioner to prescribe the time and manner for filing

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[24]The preliminary Statement to the Revenue Agent's Report recites that "[t]he net overassessment is due to valuing of inventories on the elective inventory basis and replacement of goods involuntarily liquidated".

[25]In view of the absence of newly discovered facts, fraud or mistake or error of law Macy argues that the present Commissioner did not have the power to reverse his predecessor's determination. [Citing cases: *N. S. D. Co.* v. *Kavanagh*, 191 F. 2d 831 (6th Cir. 1951); *Woodworth* v. *Kales*, 26 F. 2d 178 (6th Cir., 1928); *Penrose* v. *Skinner*, 298 Fed. 335 (D. C. Col. 1923)]. The basis on which this decision rests, however, renders consideration of this point unnecessary.

an application to use the LIFO method [Section 22 (d)(2)(A)] as well as the qualifications for the change to, and use of, that method [Section 22(d)(3)].

Pursuant to the authority thus conferred, the Commissioner—in December 1939—issued Regulations 103, Sections 19.22 (d)-1 to 19.22 (d)-6 inclusive. Within a relatively short time after these regulations were promulgated the Commissioner asserted his view, later acknowledged to be erroneous, that the elective method was not available to users of the retail method of inventory valua- [45a] tion.[26] He therefore did not (103) issue any regulations relating to adjustment of inventories theretofore taken on the retail method to a LIFO basis, either by use of a statistical price index or otherwise. This much is not denied.

Pointing to subdivision 3 of section 19.22 (d) of the Regulations, as amended by Treasury Decision 5199, 1942-2 C. B. 81, approved December 10, 1942,* the Com-

[26] In Mim. 6244, 1948-1 C. B. 21 (March 9, 1948), the Commissioner stated in part:

"1. Section 22(d)(1) of the Internal Revenue Code provides an elective method for inventorying goods, commonly referred to as the last-in, first-out, or LIFO, inventory method. Section 22 (d)(2)(A) of the Code provides that the elective method shall be applied only with respect to the goods specified by the taxpayer in an application filed with the Commissioner. The Commissioner's regulations with respect to the elective inventory method have heretofore made no provision for retailers to group such goods into classes. The Bureau has held that the use of the elective inventory method was not available to taxpayers whose inventory records are kept on the basis of the retail inventory method permitted under Section 29.22(c)-8 of Regulations 111 and Section 19.22(c)-8 of Regulations 103."

*The pertinent part of this subdivision reads as follows: "Time and manner of making election.—The elective method may be adopted and used if the taxpayer files with his return for the taxable year as of the close of which the method is first to be used (or * * *) in triplicate on Form 970 (revised), and pursuant to the instructions prescribed thereon and to the requirements of this section, a statement of his election to use such method * * *"

missioner argues that notwithstanding his refusal to issue any regulation appropriate to accomplish the general purpose of applying the LIFO method to retail merchants and his inflexible position that the elective method was not available to them, he did provide for the manner and time within which they should file a statement of election to use such method. Consequently, the Commissioner concludes, Macy's omission to file Form 970 within the [46a] time fixed in that subdivision effectively bars its right to recover in this suit.
(104)

Read *in vacuo* and isolated from the other subdivisions of section 19.22 (d), subdivision 3 is susceptible of the use to which the Commissioner would make of it here. Viewed in its entirety,[27] however, and against the background of the Commissioner's position that users of the retail method did not qualify under subdivision 2 to adopt the elective method, such use does violence to and is out of harmony with the intendment of section 19.22 (d). Unless subdivision 3 modifies subdivision 2 or supplies the void in the regulations pointed up in *Hutzler*, and the Commissioner does not so argue, subdivision 3 read together with subdivision 2 fixes the time and manner of filing the statement of election to use LIFO by taxpayers qualified under the Regulations to make that election.

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[27] Single provisions and single sentences are not to be selected and construed by themselves, but the whole must be studied together. See *Koppers Conn. Coke Co. v. James-McWilliams Blue Line*, 18 F. Supp. 992 (E. D. N. Y. 1936), aff'd 89 F. 2d 865, cert. denied 302 U. S. 706; see also, *Glenn v. U. S.*, 129 F. Supp. 914, 919 (S. D. Cal. 1955); *Adler v. Northern Hotel*, 175 F. 2d 619, 621 (7th Cir. 1949); *Dwight & Lloyd Sintering Co. v. American Ore Rec. Co.*, 263 Fed. 315 (2d Cir. 1920), cert. denied, 252 U. S. 582; *Pollard v. Bailey*, 20 Wall 520, 525-526 (1874); *United States v. Boisdore*, 8 How. 113, 122 (1850).

To construe subdivision 3 in the manner contended for by the Commissioner is, in effect, to ascribe to him a purpose to require a taxpayer to indulge in the idle and wasteful ceremony of filing a statement of an election the existence of which he steadfastly refused (105) to recognize. It would be rationally offensive to make provision for the time and manner of the filing of a statement of [47a] election by one in whom, it is asserted, the right to make an election does not reside, and to whom the right to make the election is denied. The Regulations are to be interpreted in the light of the position the Commissioner openly maintained and not on the basis of the unwarranted assumption that he was attempting to arrogate to himself, in the guise of interpretative regulations, the power to vitiate the statute. It is no answer that the statute was ultimately construed as granting to taxpayers generally the right to elect to use LIFO; for the regulations are to be construed for the purposes of this case as of March 10, 1943, unaided by wisdom acquired after the decision in *Hutzler*. Thus, it is inescapable that the purview of the original LIFO regulations did not embrace users of the retail method, not only in subdivision 2 thereof, but in subdivision 3 as well.

The failure of the Commissioner to prescribe in his regulations the time and manner of making the elections by taxpayers to whom the elective method was not available under the Regulations until after Macy's tax returns for fiscal 1942 had been filed, cannot operate to deprive Macy of the election available to it by statute. (106) *Cf. J. W. & A. P. Howard Co.*, 15 B. T. A. 1096 (1929); *Peck & Hills Furniture Co.*, 16 B. T. A. 1008 (1929). Within a reasonable time after issuance of the amended regulations adapting the retail inventory requirements of the

regulations to the elective inventory principle of section 22(d) of the Code as enunciated in *Hutzler*. Macy filed the appropriate statement of its election to adopt LIFO and had performed every act on its part to be performed to qualify for use of the elective method in computing its tax liabilities for fiscal 1942.

Kaufman & Baer Company v. *United States*, 137 F. [48a] Supp. 725 (Ct. Claims 1956) cert. denied 352 U. S. 835 is urged as authority to the contrary. In that case plaintiff filed Form 970 three weeks after the March 10, 1943 date set out in § 19.22 (d)-3. Within a month thereafter it wrote to the Commissioner with reference to the notice of election and the refund claim predicated thereon, stating in part:

> "Accordingly, we wish to advise you that we desire to withdraw this claim for refund and also to withdraw, or cancel, our application for a change in our inventory method."

The Commissioner in his reply advised that the case had been forwarded to the Agent in Charge and that it would be further advised by that official. The claim was thereafter disallowed, although it "was not really considered (107) in fact" (137 F. Supp. at p. 728), apparently because it had been withdrawn. In the subsequent suit for recovery of the claimed refund the defendant contended that the Court lacked jurisdiction since plaintiff had withdrawn its election and claim for refund. To this plaintiff countered "that the attempted withdrawal of its claim for refund was conditional on the Commissioner's allowance of the withdrawal or cancellation of its application to change its inventory method to LIFO, and that the Commissioner did not write it approving its withdrawal." (137 F. Supp. at p. 729) No reason suggests itself to the Court why, under

the circumstances in that case, disallowance of plaintiff's claim without consideration upon the merits, and the interposition of the defense that the notice of election and claim for refund had been withdrawn are less than approval by the Commissioner of withdrawal of both the claim and notice of election. [49a] Surely if the sole ground of the decision were derived from the Commissioner's aforementioned contentions, he would not have been heard to, and neither can he now validly contend that he had not acquiesced in such withdrawal. The claim for refund having been withdrawn, whether the notice of election had or had not been duly filed could not affect the result. Upon this view, the observations in *Kaufman & Baer* on the (108) timeliness of the filing of the notice of election do not, with due deference, rise above the level of *obiter dicta*.

The defendant's brief argues that administrative regulations in harmony with the statute under which they were issued are to be upheld. At issue is not whether subdivision 3 is to be upheld but rather whether it is to be expanded to encompass a class of taxpayers clearly not envisaged when it was promulgated. That the Commissioner could not by his regulations alter or amend the statute [*Norrell* v. *Jones*, 106 U. S. 466 (1882)], and that he erred in his interpretation of the scope and applicability of the statute to users of the retail method cannot be availed of to read into any part of his regulations a meaning which would include within the words "the taxpayer", as used in subdivision 3, a class consistently proclaimed by him to be excluded from the identical words in the immediately preceding subdivision of the same section.

Extended argument in defendant's brief relating to Macy's intent in 1942 to adopt statutory LIFO ends with the statement that it is not material. The affidavit in sup-

port of defendant's cross motion for summary judgment, via incorporation by reference, consists wholly of a letter dated May 18, 1954 from the Acting Commissioner of Internal Revenue to the District Director Internal Revenue Upper Manhattan, N. Y., commenting at length (109) [50a] upon the same "immaterial" matter. Exploring for Macy's intent would be useful if discovery that its failure to file Form 970 "was due to the Bureau's position of non-recognition of the right"[28] to use the LIFO method for Federal Income Tax purposes would prompt the Commissioner to reverse his reversal of his predecessor. No such suggestion is contained in the briefs; and, indeed, the position taken by the Commissioner in *Kaufman & Baer Company* v. *United States*; supra, would point to the contrary. Absent an applicable regulation fixing the time and manner for filing a statement of election no inferences may be drawn from the non-filing. Neither may an unfavorable inference as to Macy's intent be drawn from its support of the proposal put forth in 1942 by Randolph E. Paul, then tax advisor to the Secretary of the Treasury, which if enacted into law would have afforded "many taxpayers—unable to use the last-in first-out method, particularly taxpayers whose inventory consists of a large number of different products rather than a few homogeneous products",[29] substantially all the advantages of the LIFO method. Macy together with other retailers sought the safeguard against inclusion of book inventory profit in taxable income available to taxpayers who were (110) able to use the LIFO method. Confronted with opposition from all quarters it joined in recommendations for remedial legislation. That those recommendations, made before acquiescence by the Commissioner

[28] See note (23), supra.
[29] See note (11), supra.

in the determination that his construction of the statute was erroneous, differed in part from the then regulations and the statute as ultimately construed does not warrant the conclusion that given the election between statutory [51a] LIFO without the recommended change or no LIFO at all the choice would have been the latter. Rejection cannot be inferred from the failure to choose between nonexistent alternatives. *Cf. Pictorial Review Co.* v. *Helvering*, 68 F. 2d 766 (D. C. Cir. 1934); *Belknap* v. *United States*, 55 F. Supp. 90 (D. C. W. D. Kentucky 1944).

For its failure to join with *Hutzler* and others in contesting the validity of the Commissioner's interpretation of the statute, the defendant would visit upon Macy a denial of the Congressional grant of the right to adopt the elective method for all years antecedent to the decision in that case. The pervasive theme of the defendant's brief is that an "* * * erroneous interpretation of the act by the Treasury Department [does] not estop the government from asserting the tax, even though the taxpayer may have been misled by such interpretation." [citing *Langstaff* v. *Lucas*, 9 F. 2d 691 (D. C. W. D. Kentucky 1925); (111) aff'd 13 F. 2d 1022 (6th Cir. 1926), cert. denied 273 U. S. 721 (1926)]. This position mistakenly equates the consequences flowing from a taxpayer's reliance upon the Commissioner's erroneous construction of the law with those resulting from the Commissioner's omission or neglect to issue a regulation, i. e., his failure to issue an applicable regulation fixing the time for filing the statement of election by a taxpayer employing the retail method. The Commissioner's mistake was twofold: first, as reflected in sec. 19.22(d)-2 in not recognizing the right of users of the retail method to adopt LIFO; and second, in not prescribing the time and manner for such taxpayers

to file a statement of election to use LIFO. With respect to his first mistake the Commissioner, recognizing that "[e]ven tax administration does not as a matter of principle preclude considerations of fairness", *Angelus* [52a] *Milling Co.* v. *Commissioner*, 325 U. S. 293, 297 (1944), amended the LIFO regulations retroactively to all taxable years beginning after December 31, 1938. These amended regulations were issued in consonance with the suggestion in *Hutzler* that "[t]he adoption of appropriate details to accomplish the general purpose of applying the LIFO method to retail merchants could well be the subject of an administrative regulation." (8 T. C. at p. 32). (112)

Reference is not made in the amended regulations to sec. 19.22 (d)-3. However, whether the amended regulations, despite the lack of express reference to sec. 19.22 (d)-3, are to be construed as also amending that sub-section or as leaving it unchanged, the result vis-a-vis Macy is the same. For the Commissioner's error in failing to issue an applicable regulation fixing the time for filing a statement of election, Macy cannot be positioned as if an applicable regulation had been issued and it defaulted in complying therewith. Its non-compliance with an inapplicable regulation cannot be availed of as a time bar. That the Commissioner omitted to issue an applicable regulation because he erroneously interpreted the statute and that Hutzler and others successfully challenged such interpretation does not supply the omission.

The cases cited by the defendant are inapposite, and the effort to analogize them with the case at bar highlights its oversight of the problem posed in this case. In *Radiant Glass Co.* v. *Burnet*, 54 F. 2d 718 (D. C. Cir. 1931) the facts were these. The taxpayer filed its corporate income

tax return for 1922 showing no tax to be due. An audit of the return made in 1926 disclosed a number of errors as a result of which a tax deficiency, was [53a] assessed. Thereupon, a petition was filed praying that the taxable income and income tax of the taxpayer and an affiliated corporation (113) be treated and computed as a consolidation under the Revenue Act of 1921. For the year 1921 affiliated corporations were required to file consolidation returns, but for the year under review such corporations were permitted to file consolidated or separate returns at their election. In 1921 the Commissioner had ruled that taxpayer and the other corporation were not affiliated in law and, accordingly, should not file a consolidated return. Separate returns for that year were thereupon filed. The relations of the companies remaining the same, separate returns were again filed for 1922. In 1926 the Commissioner reversed his earlier ruling and permitted an amendment of the return for 1921, to wit, the year when a consolidated return was obligatory, but refused to permit an amendment of the return for 1922 when such corporations were entitled to file either separate or consolidated returns at their election. In affirming a denial of the prayer, the court held that (i) when the taxpayer came to make out and file its return for 1922 it was entitled, if affiliated with another corporation, to file either a separate or consolidated return; (ii) the ruling of the Commissioner with respect to the prior year did not prevent or impair the free exercise of that right; and (iii) the right of choice or election to file a separate or consolidated return is exercised by filing the return.
(114)

The controlling facts in *Safety Electric Products Co. Inc.* v. *Helvering*, 70 F. 2d 439 (9th Cir. 1934), are almost identical. The Revenue Act of 1926 permitted affiliated corporations to file a consolidated return or separate [54a]

returns at their election. In 1926 petitioner was affiliated with two other corporations and was entitled to file a consolidated return for the group if it elected to do so. However, a consolidated return for only two of the companies was filed—the third having filed a separate return because the Treasury Department had objected to the filing by said third company as an affiliate for the preceding year. In 1929 a consolidated return of all three companies for the year 1926 was filed. Relying upon, and quoting at length from *Radiant Glass Co.* v. *Burnet*, supra, the court held that the filing of the separate return by the third company was an election, and having made its election or choice it was bound thereby and could not afterwards change.

Lamb v. *Smith*, 183 F. 2d 938 (3rd Cir. 1950), presented two issues: whether a family partnership was to be given recognition for tax purposes; and if so, whether the husband and wife were to be permitted to file separate returns for a year in which they had previously filed a joint return. It was contended that the joint return was filed as a result of the Commissioner's refusal to (115) recognize the wife's interest in the partnership. The first issue was resolved in favor of, and the second adversely to, the taxpayers. The Commissioner's refusal to recognize the partnership, observed the court, did not prevent the taxpayers from filing separate returns, and having freely elected to file a joint return they were bound by their knowledgeable choice.

It is to be observed that in each of the three cases relied on by the government the taxpayer was given a choice by statute to file one sort of return or another and after exercising the election sought to be relieved therefrom. In each instance, too, a claim was asserted [55a] that the original choice was influenced by an erroneous determination by the Commissioner. In none of the cases, however, did the error

of the Commissioner prevent or impair the free exercise of the statutory option. There was no provision in the statutes involved in these cases for filing a notice of election to use one type of return or another separate and apart from the return itself. The election was exercisable in each instance by filing the return of the taxpayer's choice. In the case at bar on the other hand, the election to adopt LIFO was to be effectuated in part by filing a separate application at such time and in such manner as the Commissioner prescribed. The failure of the Commissioner so to prescribe with respect to users of the retail method prevented and impaired the exercise of the (116) election by Macy. Under these circumstances to deny relief to Macy would be to permit the Commissioner to benefit by his own nonfeasance.

The recommendation of the Commissioner in office in 1951 that Macy's "right to use LIFO beginning with the taxable year ended January 31, 1942, be recognized" is just and well-advised.

Accordingly, plaintiff's motion for summary judgment is granted.

Dated: January 31, 1957.

ALEXANDER BICKS
United States District Judge

[3a] Stipulation of Facts

(122)

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

CIVIL No. 96-236

R. H. MACY & CO., INC., L. BAMBERGER & CO., DAVISON-PAXON CO. and THE LASALLE & KOCH COMPANY,

Plaintiffs,

—against—

UNITED STATES OF AMERICA,

Defendant.

IT IS HEREBY STIPULATED that the following facts shall be taken as true for the purpose of the above-entitled action for refund, provided, however, that this stipulation shall be without prejudice to the right of any party to said action to introduce other and further evidence not inconsistent with the facts hereinafter stipulated to be true.

1. The action is brought to recover an internal revenue tax as hereinafter set forth. Such action is brought pursuant to, and the jurisdiction of this Court is founded upon, Title 28, United States Code, Sections 1340 and 1346(a) (1), as amended by Public Law 559, 83rd Con-

[4a] gress, (123) July 30, 1954 (68 Stat. 589). (Complaint, par. 1; admitted in answer.)

2. Plaintiff R. H. Macy & Co., Inc. (hereinafter called "Macy") is, and at all times hereinafter mentioned was, a corporation organized and existing under and by virtue of the laws of the State of New York, engaged in the operation of retail department stores, with its principal place of business at Broadway and 34th Street, New York 1, N. Y., and its principal office at 151 West 34th Street, New York 1, N. Y. (Complaint, par. 2; admitted in answer.)

3. At all times hereinafter mentioned prior to January 31, 1948, Macy was the sole stockholder of plaintiff L. Bamberger & Co. (hereinafter called "Bamberger"), a New Jersey corporation, plaintiff Davison-Paxon Co. (hereinafter called "Davison-Paxon"), a Georgia corporation, and plaintiff The LaSalle & Koch Company (hereinafter called "LaSalle & Koch"), an Ohio corporation. Bamberger, Davison-Paxon and LaSalle & Koch (sometimes hereinafter referred to as "subsidiaries") were engaged in the ownership and operation of retail department stores prior to January 31, 1948.

4. For many years prior to the fiscal year ended January 31, 1942, Macy and its subsidiaries employed the (124) retail method of inventory valuation (hereinafter sometimes called the "retail method"). The retail method then was, and it still is, an accepted method of inventory valuation under the Regulations promulgated by the Commissioner of Internal Revenue (hereinafter sometimes called the "Commissioner"). Under the retail method, as

[5a] used by large department stores, inventory records are maintained by departments in terms of selling price dollar values rather than in terms of specific items of merchandise. (Complaint, par. 4; admitted in answer).

5. The FIFO method, used by Macy and its subsidiaries prior to the fiscal year ended January 31, 1942, assumes that an article of merchandise "first-in", *i.e.*, the article purchased earliest, was the first one sold, and that the articles left in the inventory at the end of the year were the last articles purchased. To the extent that inventories are stated at cost, the cost of the items in the inventory at the end of the year would be based on the cost of the last articles purchased.

The LIFO method of inventory assumes that an article of merchandise "last-in", *i.e.*, the article purchased last, was the first sold and that the articles left in the inventory at the end of the year were the first articles purchased. To the extent that inventories are stated at cost, the cost of (125) the items in the inventory at the end of the year would be based on the cost of the first articles purchased.

In the case both of the FIFO and LIFO methods, the foregoing assumptions are made irrespective of the order in which the goods are actually sold.

The difference between FIFO and LIFO insofar as it relates to profits and taxable income is illustrated (a) in a period of rising prices and (b) in a period of falling prices as follows:

(a) During a period of rising prices, a retailer starts out with one shirt which cost him $2. He buys another

for $3. He sells one for $4. His clos- [6a] ing inventory and profits on a FIFO and LIFO basis will be as follows:

FIFO		LIFO	
Opening Inventory	$2.00	Opening Inventory	$2.00
Cost of Purchases	3.00	Cost of Purchases	3.00
Total	5.00	Total	5.00
Less Cost of Closing Inventory (last in)	3.00	Less Cost of Closing Inventory (first in)	2.00
Cost of Goods Sold	2.00	Cost of Goods Sold	3.00
Sales	$4.00	Sales	$4.00
Cost of Goods Sold	2.00	Cost of Goods Sold	3.00
Gross Margin	2.00	Gross Margin	1.00

(126)

On the FIFO basis, $1 of the $2 gross margin represents paper profit since the retailer must keep a stock of one shirt. On the LIFO basis, there is no paper profit because LIFO assumes that a retailer's basic inventory (one shirt in this example) is carried on the books at a stabilized value.

(b) During a period of falling prices, the difference between FIFO and LIFO is illustrated by the following example: Assume that in the following year, the retailer buys another shirt for $2 and sells one for $3 instead of $4. His inventory and [7a] profits on a

FIFO and LIFO basis for such second year will be as follows:

FIFO		LIFO	
Opening Inventory	$3.00	Opening Inventory	$2.00
Cost of Purchases	2.00	Cost of Purchases	2.00
Total	5.00	Total	4.00
Less Cost of Closing Inventory (last in)	2.00	Less Cost of Closing Inventory (first in)	2.00
Cost of Goods Sold	3.00	Cost of Goods Sold	2.00
Sales	$3.00	Sales	$3.00
Cost of Goods Sold	3.00	Cost of Goods Sold	2.00
Gross Margin	NONE	Gross Margin	1.00

(127)

In the first year in which a taxpayer changes from FIFO to LIFO, opening inventories are always the same under either basis, if stated at cost.

6. Under the retail method, the inventory of a particular department is determined, in substance, as follows:

(1) on the day physical inventory is taken, the retail price of all merchandise in stock is taken from the price tag or other price marking on the [8a] merchandise, and the aggregate dollar amount of the inventory, at retail prices, is determined;

(2) from vendors' invoices for the merchandise purchased, there is accumulated the cost shown thereon and the amount calculated at retail prices (inserted thereon by the department manager) and, from that accumulation for the accounting period (including the opening inventory), there is determined the ratio* of the aggregate cost to the aggregate amount at retail, and

(3) the figure resulting from multiplying the aggregate dollar amount at retail in (1) above by the ratio as determined in (2) above is the inventory for such department.

For years prior to the fiscal year ended January 31, 1942, Macy and its subsidiaries used the foregoing method and in (128) common with other retail department stores using the retail inventory method, calculated the so-called mark-up factor by taking mark-ups, but not mark-downs, into account in the calculation described in (2) above. In general, the effect of such method is to obtain a basis for the inventories of approximate cost in a period of constant or rising prices and of approximate market in a period of falling prices. To the extent that prices run counter to the trend, there is to that extent a deviation from the general rule.

7. In 1942 and 1943 and continuously thereafter until 1948, the Commissioner and other representatives of the Treasury Department and the Bureau of Internal Revenue took the position that LIFO was not available [9a]

*The difference between this ratio and 100% is the mark-up factor.

to users of the retail method since such users determined their inventories in terms of dollar values rather than in terms of specific goods, with the result that the Commissioner and such other representatives maintained that the specification required by Section 22(d) of the Code* was lacking. Due to the multiplicity of items carried by retail department stores and the varying price ranges of those items, it is not practicable to account for the inventories of those stores on an item basis.

8. In 1942 Macy and other retailers, as well as representatives of the National Retail Dry Goods Association, (129) held conferences with various representatives of the Treasury Department and the Bureau of Internal Revenue in order, among other things, to urge those agencies to abandon the position maintained by them, as described in paragraph 7 above.

9. Notwithstanding the opposition of the Commissioner and other representatives of the Treasury Department as described in paragraph 7 above, some retail department stores filed Treasury Department Form 970 with their Federal income tax returns for fiscal years ended in 1942. While the parties have not been able to determine the exact number of such retail department stores, it is believed that the number may be about 70. A substantial number, if not all, of such retail department stores, including Hutzler Brothers Company, calculated the mark-up factor by taking mark-ups, but not mark-downs, into account, and they adjusted closing inventories to LIFO by an index of retail price changes that was not then or thereafter authorized or approved by the Treasury Department or the Bureau of Internal Revenue.

*"Code" references are to the Internal Revenue Code of 1939.

[10a] 10. The following is an extract from the minutes of meeting held by the Executive Committee of Macy's Board of Directors on March 20, 1942:

> "LIFO—a method of evaluating merchandise inventories (Last-in First-out) was discussed and it was decided to adopt this method for the purpose of determining the operating profit to be reflected in the Stockholders Annual Report for the year (130) 1941. However, with respect to the Federal Income Taxes, it was decided to ask for a sixty-day extension, and if need be for a second sixty-day extension, so that we would be able to study the new tax law before filing a final Federal Income Tax return."

11. The following is an extract from the minutes of a meeting held by the Macy Board of Directors on March 25, 1942:

> "The Treasurer reported that, after full consideration of the matter, the Executive Committee at its meeting on March 20, 1942, had decided to recommend that the so-called 'LIFO' (Last-In-First-Out) method of valuing inventories of the Corporation and its subsidiaries be adopted for purposes of the Annual Report to stockholders for the fiscal year ended January 31, 1942; and that decision as to the method of valuing inventories for tax purposes for that year be deferred pending further study of the matter in the light of possible amendments to the tax laws relative thereto.
>
> "After due discussion and deliberation, and on motion duly made and seconded, the following resolution was unanimously adopted:
>
> [11a] "RESOLVED, that the Board of Directors of this Corporation does hereby authorize that the so-called 'LIFO' (Last-In-First-Out) method

of valuing inventories of this Corporation and its subsidiaries be adopted for purposes of the Annual Report to stockholders for the fiscal year ended January 31, 1942; and does hereby direct that decision as to the method of valuing such inventories for tax purposes for that year be and the same hereby is deferred pending further study of the matter in the light of the existing tax laws and possible amendments which may be made thereto and applicable to that year, prior to the filing of the tax returns for said fiscal year; and that the principal officers of this Corporation, and each of them, be and they hereby are authorized to request and obtain such extensions of time for the filing of tax returns for that year and to take any and all such other action in connection therewith as they may deem necessary and proper."

(131)

12. Attached hereto and made part hereof as Exhibit 1 is a true copy of the Annual Report of Macy and its subsidiaries for the fiscal year ended January 31, 1942. The opening inventories for said fiscal year were arrived at for purposes of said Annual Report by use of the retail method, as described in paragraphs 4, 5 and 6 above. The LIFO adjustments in connection with closing inventories were based upon an index of retail price changes prepared by the National Industrial Conference Board.

[12a] 13. Attached hereto and made part hereof as Exhibit 2 is a true copy of the Macy Prospectus dated May 25, 1942, relating to a $12,000,000 issue of Ten-Year 2½% Sinking Fund Debentures.

14. The taxes shown on the tentative United States income and declared value excess profits tax returns of

Macy and its subsidiaries for the fiscal year ended January 31, 1942, which were filed in April 1942, were computed according to the retail method described in paragraphs 4, 5 and 6 above and by making the LIFO adjustments in connection with closing inventories based upon an index of retail price changes prepared by the National Industrial Conference Board. The regular books of account of Macy and its subsidiaries for the fiscal year ended January 31, 1942 were kept on the same basis.

(132)

15. Attached hereto and made part hereof as Exhibit 3 is a copy of a statement made on June 15, 1942, by Randolph E. Paul, tax adviser to the Secretary of the Treasury, before the Ways and Means Committee of the House of Representatives with respect to the proposed amendment of the Internal Revenue Code regarding inventory reserves.

16. Attached hereto and made part hereof as Exhibits 4 and 5 are copies of the following letters:

(a) letter dated June 30, 1942, to Macy from Leon Lauterstein, Macy's then general counsel. The reference to Mr. Friedman in this letter is a reference to Mr. J. P. Friedman of Touche, Niven & Co., Macy's auditors.

[13a] (b) letter to Macy dated July 3, 1942, from Mr. Lauterstein.

On July 3, 1942, Macy's Executive Committee authorized Touche, Niven & Co. to file Federal income tax returns for the fiscal year ended January 31, 1942, in the manner

recommended by Mr. Lauterstein's aforesaid letters of June 30 and July 3, 1942.

17. Attached hereto and made part hereof as Exhibit 6 is a copy of the federal income and declared value excess profits tax return of Macy for the fiscal year ended (133) January 31, 1942, which was filed on July 15, 1942. There have been omitted from said Exhibit certain lengthy schedules which the parties do not deem to be pertinent. The opening and closing inventories shown in Schedule A thereof were computed in the manner described in paragraphs 12 and 14 above, and were in the same amounts as were included in the Annual Report of Macy and its subsidiaries for that year. Cost of purchases was shown on Macy's books as $68,850,906.75, which was the actual cost of purchases; whereas cost of purchases was shown in Schedule A of the return as $67,233,491.75. The difference between these two figures, amounting to $1,617,415.00 (shown as Item 7 (j) of Schedule M of the return), represents the amount of the adjustment which was necessary in order to state cost of goods sold on the return on the FIFO basis. Substantially similar methods were used in the returns of Bamberger, Davison-Paxon and LaSalle & Koch for the fiscal year ended January 31, 1942. Those returns for that fiscal year were filed on or about July 15, 1942.

18. The minutes of meeting of the Executive Com- [14a] mittee of the Macy Board of Directors held on August 21, 1942, state in part as follows:

"The Secretary reported that as authorized in the minutes of July 3, 1942, the Federal Corporate Tax Return, had been filed on the basis of valuing inven-

tories under the retail method, as provided in the present law and not under the LIFO method."

19. Until October 21, 1942, the date of approval of the Revenue Act of 1942, Section 22(d)(B) of the Code and (.134) Treasury Regulations 101, as amended by T. D. 4959 (1940-1 Cum. Bull. 22), approved December 28, 1939, limited the use of LIFO to taxpayers who could establish as a fact that they had not used any procedure other than the procedure set forth in Section 22(d)(1)(B) and (C) of the Code in inventorying goods, for the purpose of reports to stockholders or creditors, for any period during the first taxable year for which the LIFO method was to be used. As Macy and its subsidiaries had issued a consolidated semi-annual report to stockholders on a basis other than the basis set forth in said Section 22(d)(1)(B) and (C) for the six months period ended August 2, 1941, they were ineligible to use LIFO for income tax purposes prior to October 21, 1942.

20. Section 118 of the Revenue Act of 1942 removed the prohibition against the adoption of LIFO for a year during which interim reports had been issued on a basis other than the basis set forth in the preceding paragraph. This change was retroactive to taxable years beginning after December 31, 1938. It retained the requirement that annual reports be made on said basis.

[15a] 21. The final United States corporation income and declared value excess profits tax returns of Macy and its subsidiaries for the fiscal year ended January 31, 1942, were timely filed with, and the tax shown thereon was on

or about the statutory instalment dates timely paid to, the (135) Collectors of Internal Revenue as follows:

Company	Collector's Office Where Returns Filed and Tax Paid	Amount of Tax Paid
(a) Macy	3d District New York, N. Y.	$1,212,493.92
(b) Bamberger	5th District Newark, N. J.	586,444.35
(c) Davison-Paxon	Atlanta, Ga.	176,106.67
(d) LaSalle & Koch	Toledo, Ohio	188,518.99

Additional amounts of such tax for said fiscal year were assessed and, on February 6, 1951, were paid to the Collector of Internal Revenue for the Third District of New York as follows:

Company	Amount of Tax Paid
(e) Bamberger	$14,143.06
(f) Davison-Paxon	591.02

(Complaint, par. 10; admitted in answer.)

The United States corporation income and declared value excess profits tax returns of Macy and its subsidiaries for the fiscal year ended January 31, 1942, were prepared and filed on the accrual basis of accounting, the method of accounting regularly maintained on the books of account of Macy and its subsidiaries.

[16a] (136)

22. Attached hereto and made part hereof as Exhibit 7 is a copy of pages S-32 and S-33 of the explanatory notes to the financial statement comprising Item 8 of

Macy's interim report on Form 10-K dated November 25, 1942, to the Securities and Exchange Commission for Macy's 26-week fiscal period ended August 1, 1942.

23. As of August 1, 1942, Macy and its subsidiaries changed their fiscal year for book purposes so as to end on the Saturday nearest July 31, although their fiscal year for Federal tax purposes continued to end on January 31. Attached hereto and made part hereof as Exhibit 8 is the audited report of Macy and its subsidiaries for the six-months period ended August 1, 1942.

24. Attached hereto and made part hereof as Exhibit 9 is a copy of a letter dated December 17, 1942 from the National Retail Dry Goods Association to its members enclosing a memorandum dated December 17, 1942 entitled "The Lifo Situation Up-to-Date."

25. Attached hereto and made part hereof as Exhibits 10 and 11 are a copy of the Annual Report to stockholders of Macy and its subsidiaries for the fiscal years ended July 31, 1943 and July 31, 1948, respectively.

26. On February 5, 1944, in pursuance of the position maintained by the Commissioner and other representatives of the Treasury Department, as described in paragraph (137) 7 above, the Bureau of Internal Revenue issued a deficiency notice to Hutzler Brothers Company, a Baltimore department store (one of the approximately 70 retailers referred to in paragraph 9 above) that filed Treasury Department Form 970 on the LIFO basis with its Federal income tax return for the fiscal year ended [17a] January 31, 1942. That deficiency notice disapproved the adoption and use by Hutzler Brothers Company of LIFO by employ-

ment of retail price index figures in connection with the retail inventory method for the taxable year of said Company ended January 31, 1942. In 1947 The Tax Court of the United States decided (8 T. C. 14) in favor of the adoption and use of LIFO by Hutzler Brothers Company by employment of retail price index figures in connection with the retail inventory method for that company's taxable year ended January 31, 1942. Subsequently to the Tax Court's decision in the *Hutzler* case, the Commissioner published Mimeograph 6244, 1948-1 C. B. 21 (March 9, 1948). As a result of the decision in the *Hutzler* case, the LIFO regulations were amended. See Treasury Decision 5605, 1948-1 C.B. 16, March 4, 1948. The amendment was made retroactive to all taxable years beginning after December 31, 1938.

27. On January 31, 1948, Bamberger, Davison-Paxon and LaSalle & Koch were completely liquidated, and their property and assets, including the claims for refund of tax alleged in the complaint herein, were distributed (138) to Macy in complete cancelation and redemption of all of its stock in each of said subsidiaries. Although each of the aforesaid subsidiaries was completely liquidated on January 31, 1948, the corporate existence of each of said subsidiaries has continued to date, and each of said subsidiaries is, under the law of its state of incorporation, capable of suing and being sued in its own name.

28. Claims (on Treasury Department Form 843) for refund of income tax and declared value excess profits tax for the fiscal year ended January 31, 1942, were timely filed with the Collector of Internal Revenue for the Third District of New York on October 18, 1948 on behalf [18a] of Macy and on October 15, 1948, on behalf of Macy's sub-

sidiaries. Said claims were based upon the contention that Macy and its subsidiaries had validly elected to use the LIFO method of inventory valuation for said fiscal year pursuant to the provisions of Section 22(d) (1)-(5) of the Code. Said claims for refund are in the following amounts:

Company	Amount
(a) Macy	$433,334.04
(b) Bamberger	141,913.73
(c) Davison-Paxon	37,502.38
(d) LaSalle & Koch	32,484.62
Total	$645,234.77

(139)

Attached hereto and made part hereof as Exhibit 12 is a folder containing a copy of said claims for refund and the exhibits thereto. Attached to each of said claims for refund is Treasury Department Form 970 executed by officers of Macy and its subsidiaries duly authorized to execute such form. Neither Macy nor its subsidiaries had filed such Form 970 with their returns for the fiscal year ended January 31, 1942 or prior to the filing of said claims for refund.

29. Further claims (on Treasury Department Form 843) for refund of income tax and declared value excess profits tax for the fiscal year ended January 31, 1942, were timely filed on behalf of Macy and its subsidiaries with the Collector of Internal Revenue for the Third District of New York. The ground of said refund claims is [19a] that Macy and said subsidiaries were entitled, in valuing inventories for said fiscal year, to take into account the

involuntary liquidation and replacement provisions contained in Section 22(d)(6) of the Code. Said claims for refund were filed on the following dates and in the following amounts:

(140)

Company	Amount	Date Refund Claim Filed
(a) Macy	$32,085.80	October 18, 1948
(b) Bamberger	13,141.87	October 15, 1948
(c) Davison-Paxon	2,599.34	October 15, 1948
(d) LaSalle & Koch	2,363.40	October 15, 1948
Total	$50,190.41	

Amended claims for refund on behalf of Macy and its subsidiaries on the aforesaid ground of involuntary liquidation and replacement were timely filed as follows:

(i) *First amended claims filed as follows:*

Company	Collector of Internal Revenue	Amount	Date Refund Claim Filed
(e) Macy	3rd District, New York, N. Y.	$40,810.04	Oct. 8, 1951
(f) Bamberger	5th District, Newark, N. J.	15,214.32	Oct. 9, 1951
(g) Davison-Paxon	Atlanta, Ga.	5,080.00	Oct. 10, 1951
(h) LaSalle & Koch	Toledo, Ohio	2,552.71	Oct. 10, 1951
	Total	$84,537.07	

[20a] (141)

(ii) *Second amended claims filed on or about November 3, 1952:*

(i) Macy	3d District New York, N. Y.	$55,419.25
(j) Bamberger	5th District, Newark, N. J.	17,050.52
(k) Davison-Paxon	Atlanta, Ga.	7,073.12
(l) LaSalle & Koch	Toledo, Ohio	2,475.00
	Total	$82,017.89

(Complaint, par. 18; admitted in answer.)

Attached hereto and made part hereof as Exhibit 13 is a folder containing copies of the claims for refund filed by plaintiffs on the ground of involuntary liquidation and replacement of inventory for the fiscal year ended January 31, 1942. Attached to said Exhibit 13 are the first amended and second amended claims for refund as alleged in paragraph 18 of the complaint herein.

30. Attached hereto and made part hereof as Exhibit 14 is a copy of a letter dated January 31, 1951 from then Deputy Commissioner of Internal Revenue E. I. McLarney to the Internal Revenue Agent in Charge, Upper New York Division, New York, N. Y. The foregoing letter was not communicated to Macy through any official channel of the Treasury Department. Macy did, however, receive a letter under even date signed by Deputy Commissioner McLarney, a copy of which (142) is attached hereto and made part hereof as Exhibit 15. Said [21a] letter was in response to Macy's January 15, 1951 application to the Commissioner for a ruling relating to

adoption of the LIFO method. A copy of said January 15, 1951 letter from Macy to the Commissioner is attached hereto and made part hereof as Exhibit 16.

31. Macy for itself and its subsidiaries requested of the Commissioner of Internal Revenue on August 8, 1951, that, if the election of involuntary liquidation in the aforesaid claims and amended claims for refund, as alleged in paragraph 18 of the complaint herein, was not regarded as timely, an extension of time should be granted within which such election could be made. On August 17, 1951, then Commissioner of Internal Revenue John B. Dunlap granted such request for an extension of time to September 30, 1951, within which to make such election (Complaint, par. 20; admitted in answer). Statements of election pursuant to such extension of time were filed by Macy for itself and its subsidiaries on or about September 25, 1951. Copies of such statements of election are attached hereto and made part hereof as Exhibit 17. Attached hereto and made part hereof as Exhibits 18 and 19, respectively, are a letter dated August 8, 1951 from Macy to the Commissioner and a letter dated August 17, 1951 in reply from the Commissioner to Macy. Also attached hereto (143) and made part hereof as Exhibits 20 and 21, respectively, are Macy's August 20, 1951 telegram to the Commissioner and the latter's August 21, 1951 telegram in reply.

32. Attached hereto and made part hereof as Exhibits 22, 23, 24 and 25, respectively, are copies of separate letters sent to Macy, Bamberger, Davison-Paxon and LaSalle & Koch under date of October 31, 1951, by the [22a] Internal Revenue Agent in Charge, Upper New York

Division, New York, New York, enclosing in each case a Revenue Agent's Report dated July 2, 1951, relating primarily to the fiscal year ended January 31, 1942. Such Revenue Agent's Reports are included in the attached Exhibits. The aforesaid separate letters were sent by the Internal Revenue Agent in Charge to Macy and its subsidiaries pursuant to the recommendation contained in Deputy Commissioner McLarney's aforesaid January 31, 1951 letter to the Internal Revenue Agent in Charge.

33. Despite the aforesaid letters and the aforesaid Revenue Agent's Reports dated July 2, 1951, the proposed overassessments as set forth in such Revenue Agent's Reports were not certified for payment, and the amounts of said proposed overassessments were not paid to Macy or any of its subsidiaries by credit or otherwise. (Complaint, par. 22; admitted in answer.)

34. A substantial number, if not all, of the (144) retail department stores mentioned in paragraph 9 above, including Hutzler Brothers Company, Federated Department Stores, Inc., and Allied Stores Corporation, have been allowed by the Commissioner of Internal Revenue to use the LIFO method beginning with their fiscal years ended in 1942, despite the fact that the Treasury Department Form 970 that those retail department stores filed with their Federal income tax returns for their fiscal years ended in 1942, used an index of retail price changes that was not authorized or approved by the Treasury Department or the Bureau of Internal Revenue and despite the further fact that in calculating the so-called mark-up factor, mark-ups but not mark-downs were taken into account. After the LIFO regulations were amended [23a] in March 1948, those retail department stores did not file any new Treasury Department Forms 970 but were per-

mitted by the amended LIFO Regulations referred to in paragraph 26 above to file new schedules for fiscal 1942 on which they took into account mark-downs as well as mark-ups and on which they used indices of retail price changes that were then authorized by the Bureau of Internal Revenue. When Macy and its subsidiaries in October 1948 filed their claims for refund (paragraphs 28 and 29 above), the amounts of the claimed refunds were computed in accordance with the LIFO Regulations as amended in March 1948, *viz.*, by taking into account mark- (145) downs as well as mark-ups in the computation of opening and closing inventories, and by applying to closing inventories the Bureau of Labor Statistics department store index of retail price changes, an index that was then authorized by the aforesaid Regulations.

35. Attached hereto and made part hereof as Exhibit 26 is a folder containing copies of separate letters addressed to Macy and its subsidiaries on or about August 27, 1954 by Harold B. A'Hearn, District Director of Internal Revenue, Upper Manhattan, New York, enclosing statements proposing to disallow the claims for refund and the first amended and second amended claims for refund as alleged in paragraphs 17 and 18 of the complaint herein.

36. Attached hereto and made part hereof as Exhibit 27 are copies of the statutory notices of disallowance sent to plaintiffs Macy and Bamberger by the Commissioner of Internal Revenue by registered mail on November 24, 1954 in respect of the fiscal year ended January 31, 1942.

[24a] 37. The parties hereto agree that if the Court finds that there has been a timely election of LIFO by plain-

tiffs for the fiscal year ended January 31, 1942 for tax purposes, then there has also been for that fiscal year a timely election by plaintiffs of the involuntary liquidation and replacement provisions of Section 22(d)(6) (146) of the Code. In the event it is held that Macy and its subsidiaries are entitled to refunds of tax as alleged in the complaint herein, it is agreed that the amount of such refunds will be computed subsequent to the decision of this Court on the merits. It is also agreed that if the Court enters its decision for plaintiffs, interest on the amount of the judgment is allowable as provided by law. It is further agreed that in the event it is held that plaintiffs are entitled to refunds of tax, as aforesaid, judgment for the entire amounts of such refunds may be entered in favor of Macy on its own behalf and as successor to Bamberger, Davison-Paxon and LaSalle & Koch.

July , 1955.

CRAVATH, SWAINE & MOORE,

by .....
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Attorney for Defendant.

STATUTES, REGULATIONS AND RULINGS

Statutes

INTERNAL REVENUE CODE OF 1939:

SEC. 22. GROSS INCOME.

(c) *Inventories.* Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

(d) (1) A taxpayer may use the following method (whether or not such method has been prescribed under subsection (c)) in inventorying goods specified in the application required under paragraph (2):

(A) Inventory them at cost;

(B) Treat those remaining on hand at the close of the taxable year as being: First, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof, and second, those acquired in the taxable year; and

(C) Treat those included in the opening inventory of the taxable year in which such method is first used as having been acquired at the same time and determine their cost by the average cost method.

(2) The method described in paragraph (1) may be used—

(A) Only in inventorying goods (required under subsection (c) to be inventoried) specified in an appli-

cation to use such method filed at such time and in such manner as the Commissioner may prescribe; and

(B) Only if the taxpayer establishes to the satisfaction of the Commissioner that the taxpayer has used no procedure other than that specified in subparagraphs (B) and (C) of paragraph (1) in inventorying [(to ascertain income, profit, or loss, for credit purposes, or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries) such goods for any period beginning with or during the first taxable year for which the method described in paragraph (1) is to be used.] *such goods to ascertain the income, profit, or loss of the first taxable year for which the method described in paragraph (1) is to be used, for the purpose of a report or statement covering such taxable year (i) to shareholders, partners, or other proprietors, or to beneficiaries, or (ii) for credit purposes.**

(3) The change to, and the use of, such method shall be in accordance with such regulations as the Commissioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income.

(4) In determining income for the taxable year preceding the taxable year for which such method is first used, the closing inventory of such preceding year of the goods specified in such application shall be at cost.

(5) If a taxpayer, having complied with paragraph (2), uses the method described in paragraph (1) for any taxable year, then such method shall be used in all subsequent taxable years unless—

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*Material in brackets deleted and material in italics added by Revenue Act of 1942, Section 118(a), 56 Stat. 814.

(A) With the approval of the Commissioner a change to a different method is authorized; or

(B) The Commissioner determines that the taxpayer has used for [any period beginning with or during] any *such* subsequent taxable year some procedure other than that specified in subparagraph (B) of paragraph (1) in inventorying [(for ascertaining income, profit, or, loss, for credit purposes, or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries)] the goods specified in the application *to ascertain the income, profit, or loss of such subsequent taxable year for the purpose of a report or statement covering such taxable year (i) to shareholders, partners, or other proprietors, or beneficiaries, or (ii) for credit purposes;* and requires a change to a method different from that prescribed in paragraph (1) beginning with such subsequent taxable year or any taxable year thereafter.

In either of the above cases, the change to, and the use of, the different method shall be in accordance with such regulations as the Commissioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income.*

Regulations

REGULATIONS 103:

SEC. 19.22(c)–8. *Inventories of retail merchants.*—Retail merchants who employ what is known as the "retail method" of pricing inventories may make their returns

*Material in brackets deleted and material in italics added by Revenue Act of 1942, Section 18(b), 56 Stat. 814.

upon that basis, provided (1) that the use of such method is designated upon the return, (2) that accurate accounts are kept, and (3) that such method is consistently adhered to unless a change is authorized by the Commissioner as provided in section 19.41–2. Under this method the total of the retail selling prices of the goods on hand at the end of the year in each department or of each class of goods is reduced to approximate cost by deducting therefrom an amount which bears the same ratio to such total as—

(*a*) the total of the retail selling prices of the goods included in the opening inventory plus the retail selling prices of the goods purchased during the year, with proper adjustment to such selling prices for all mark-ups and mark-downs,

less

(*b*) the cost of the goods included in the opening inventory plus the cost of the goods purchased during the year,

bears to (*a*).

This amount should represent as accurately as may be the amounts added to the cost price of the goods to cover selling and other expenses of doing business and for the margin of profit.

*For further adjustments to be made in the case of a retail merchant using the elective inventory method authorized by section 22(d), see section 19.22(d)-1.**

A taxpayer maintaining more than one department in his store or dealing in classes of goods carrying different percentages of gross profit should not use a percentage of

*Added by T. D. 5605, 1948-1 Cum. Bull. 16.

profit based upon an average of his entire business, but should compute and use in valuing his inventory the proper percentages for the respective departments or classes of goods.

A taxpayer (*other than one using the elective inventory method*)* who previously has determined inventories in accordance with the foregoing, except that, to obtain a basis of approximate cost or market, whichever is lower, the practice has been followed, consistently and uniformly, of adjusting the retail selling prices of the goods included in the opening inventory and purchased during the year for mark-ups but not for mark-downs, may continue such practice subject to the conditions herein prescribed. The adjustments must be bona fide and consistent and uniform. Where mark-downs are not included in the adjustments, mark-ups made to cancel or correct mark-downs shall not be included; and the mark-ups included must be reduced by the mark-downs made to cancel or correct such mark-ups.

In no event shall mark-downs not based on actual reduction of retail sales prices, such as mark-downs based on depreciation and obsolescence, be recognized in determining the retail selling prices of the goods on hand at the end of the year.

A taxpayer (*other than one using the elective inventory method*)* who previously has determined inventories without following the practice of eliminating mark-downs in making adjustments to retail selling prices, may adopt such practice, provided permission to do so is obtained in accordance with, and subject to the terms provided by, section 19.41-2. A taxpayer filing a first return of income may adopt such practice subject to approval by the Commissioner upon examination of the return.

*Added by T. D. 5605, 1948-1 Cum. Bull. 16.

*A taxpayer using the elective inventory method in conjunction with retail computations must adjust retail selling prices for mark-downs as well as mark-ups, in order that there may be reflected the approximate cost of the goods on hand at the end of the year, regardless of market values.**

SEC. 19.22(d)–1. *Inventories under elective method.*— Any taxpayer permitted or required to take inventories pursuant to the provisions of section 22(c), and pursuant to the provisions of sections 19.22(c)–1 to 19.22(c)–8, inclusive, may elect with respect to those goods specified in his application and properly subject to inventory to compute his opening and closing inventories in accordance with the method provided by section 22(d), as amended. Under this elective inventory method, the taxpayer is permitted to treat those goods remaining on hand at the close of the taxable year as being:

First, those included in the opening inventory of the taxable year, in the order of acquisition and to the extent thereof, and

Second, those acquired during the taxable year.

This elective inventory method is not dependent upon the character of the business in which the taxpayer is engaged, or upon the identity or want of identity through commingling of any of the goods on hand, and may be adopted by the taxpayer as of the close of any taxable year beginning after December 31, 1938.

If the elective inventory method is used by a taxpayer who regularly and consistently, in a manner similar to hedg-

*Added by T. D. 5605, 1948-1 Cum. Bull. 16.

ing on a futures market, matches purchases with sales, then firm purchase and sales contracts (i.e., those not legally subject to cancellation by either party) entered into at fixed prices on or before the date of the inventory may be included in purchases or sales, as the case may be, for the purpose of determining the cost of goods sold and the resulting profit or loss, provided that this practice is regularly and consistently adhered to by the taxpayer and that, in the opinion of the Commissioner, income is clearly reflected thereby.

SEC. 19.22(d)-2. *Requirements incident to adoption and use of elective method.*—The adoption and use of the elective inventory method is, by section 22(d) and regulations thereunder, made subject to the following requirements:

(1) The taxpayer shall file an application to use such method specifying with particularity the goods to which it is to be applied;

(2) The inventory shall be taken at cost regardless of market values;

(3) Goods of the specified type included in the opening inventory of the taxable year for which the method is first used shall be considered as having been acquired at the same time and at a unit cost equal to the actual cost of the aggregate divided by the number of units on hand[, such]. *The* actual cost of the aggregate [being] *shall be* determined pursuant to the inventory method employed by the taxpayer under the regulations applicable to the preceding taxable year *with the exception that restoration shall be made with*

*respect to any write-down to market values resulting from the pricing of former inventories;**

(4) Goods of the specified type on hand as of the close of the taxable year in excess of what were on hand as of the beginning of the taxable year shall be included in the closing inventory, regardless of identification with specific invoices, at costs determined as follows:

(*a*) By reference to the actual cost of the goods most recently purchased or produced;

(*b*) By reference to the actual cost of the goods purchased or produced during the taxable year in the order of acquisition;

(*c*) By application of an average unit cost equal to the aggregate cost of all the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced, the goods reflected in such inventory increase being considered for the purposes of section 22(d) as having been acquired all at the same time; or

(*d*) Pursuant to any other proper method which, in the opinion of the Commissioner, clearly reflects income.

Whichever of the several methods of valuing the inventory increase is adopted by the taxpayer and approved by the Commissioner shall be consistently adhered to in all subsequent taxable years so long as the elective inventory method is used by the taxpayer;

Example (*1*): Suppose that the taxpayer adopts the elective inventory method for the taxable year 1939 with

*Material in brackets deleted and material in italics added by T. D. 5163, 1942-2 Cum. Bull. 80.

an opening inventory of 10 units at 10 cents per unit, that it makes 1939 purchases of 10 units as follows:

January	1 @ 11	=	11
April	2 @ 12	=	24
July	3 @ 13	=	39
October	4 @ 14	=	56
Totals:	10		130

and that it has a 1939 closing inventory of 15 units. This closing inventory, depending upon the taxpayer's method of valuing inventory increases, will be computed as follows:

(*a*) Most recent purchases—

10 @ 10		=	100
4 @ 14	(October)	=	56
1 @ 13	(July)	=	13
Totals: 15			169

or

(*b*) In order of acquisition—

10 @ 10		=	100
1 @ 11	(January)	=	11
2 @ 12	(April)	=	24
2 @ 13	(July)	=	26
Totals: 15			161

or

(*c*) At an annual average—

10 @ 10		=	100
5 @ 13	(130/10)	=	65
Totals: 15			165

Example (2): Suppose, in addition to the facts stated in example (1), that there is a 1940 closing inventory of 13 units. This closing inventory, being determined wholly by reference to the opening inventory, and being taken in the order of acquisition, and depending upon the taxpayer's method of valuing its inventory increase for the preceding taxable year, will be computed as follows:

(*a*) In case the increase was taken as most recent purchases—

10	@ 10	(from 1938)	= 100
1	@ 13	(July, 1939)	= 13
2	@ 14	(October, 1939)	= 28
Totals: 13			141

or

(*b*) In case the increase was taken in order of acquisition—

10	@ 10	(from 1938)	= 100
1	@ 11	(January, 1939)	= 11
2	@ 12	(April, 1939)	= 24
Totals: 13			135

or

(*c*) In case increase was taken on basis of an average—

10	@ 10	(from 1938)	= 100
3	@ 13	(from 1939)	= 39
Totals: 13			139

(5) The taxpayer shall establish to the satisfaction of the Commissioner that the taxpayer [has not], in *ascer-*

taining income, profit, or loss for the taxable year for which the elective inventory method is first used or [in] *for* any subsequent taxable year, [used in determining income, profit, or loss,] for credit purposes [,] or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries, *has not used* any inventory method other than that referred to in section 19.22(d)–1 or at variance with the requirement referred to in paragraph (3) of this section, the taxpayer's use of market value in lieu of cost *or his issuance of reports or credit statements covering a period of operations less than the whole of the taxable year* not being considered at variance with this requirement;*

(6) Goods of the specified type on hand as of the close of the taxable year preceding the taxable year for which this inventory method is first used, whether such preceding taxable year began before or after December 31, 1938, shall be included in the taxpayer's *closing* inventory for such preceding taxable year at cost *determined in the manner prescribed in paragraph (3) of this section;***

(7) The elective inventory method, once adopted by the taxpayer with the approval of the Commissioner, shall be adhered to in all subsequent taxable years unless—

(*a*) A change to a different method is approved by the Commissioner; or

(*b*) The Commissioner determines that the taxpayer [has used], in ascertaining income, profit[s], or loss *for the whole of any taxable year subsequent to his adoption of the elective inventory method*, for credit

*Material in brackets deleted and material in italics added by T. D. 5199, 1942-2 Cum. Bull. 81, 83.

**Material in italics added by T. D. 5163, 1942-2 Cum. Bull. 80.

purposes or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries, [and for years subsequent to his adoption of the elective inventory method,] *has used* any inventory method at variance with that referred to in section 19.22(d)-1, and requires of the taxpayer a change to a different method for such subsequent taxable year or any taxable year thereafter;* and

(8) [The taxpayer shall maintain such accounting records] *The records and accounts employed by the taxpayer in keeping his books shall be maintained in conformity with the inventory method referred to in section 19.22(d)-1; and such supplemental and detailed inventory records shall be maintained* as will enable the Commissioner readily to verify the taxpayer's inventory computations as well as his compliance with these several requirements.*

SEC. 19.22(d)-3. *Time and manner of making election.* The elective inventory method may be adopted and used only if the taxpayer files with his return for the taxable year as of the close of which the method is first to be used (or, if such return is filed prior to *March 10, 1943*, the ninetieth day after the approval of Treasury Decision [4959, approved December 28, 1939] *5199*, then at any time prior to [the expiration of such ninetieth day] *such date)*, in triplicate on Form 970 (revised), and pursuant to the instructions printed thereon and to the requirements of this section, a statement of his election to use such inventory method. Such statement shall be accompanied by an analysis of all inventories of the taxpayer as of the beginning and as of

*Material in brackets deleted and material in italics added by T. D. 5199, 1942-2 Cum. Bull. 81, 84.

the end of the taxable year for which the elective method is proposed first to be used, and also as of the beginning of the preceding taxable year. In the case of a manufacturer, this analysis shall show in detail the manner in which costs are computed with respect to raw materials, goods in process, and finished goods, segregating the products (whether in process or finished goods) into natural groups on the basis of either (1) similarity in factory processes through which they pass, or (2) similarity of raw materials used, or (3) similarity in style, shape, or use of finished products. Each group of products shall be clearly described.*

The taxpayer shall submit for the consideration of the Commissioner in connection with the taxpayer's adoption or use of the elective inventory method such other detailed information with respect to his business or accounting system as may be at any time requested by the Commissioner.

As a condition to the taxpayer's use of the elective inventory method, the Commissioner may require that the method be used with respect to goods other than those specified in the taxpayer's statement of election if, in the opinion of the Commissioner, the use of such method with respect to such other goods is essential to a clear reflection of income.

Whether or not the taxpayer's application for the adoption and use of the elective inventory method should be approved, and whether or not such method, once adopted, may be continued, and the propriety of all computations incidental to the use of such method will be determined by the Commissioner in connection with the examination of the taxpayer's returns.

SEC. 19.22(d)—4. *Adjustments to be made by taxpayer.* —A taxpayer may not change to the elective method of tak-

*Material in brackets deleted and material in italics added by T. D. 5199, 1942-2 Cum. Bull. 81, 84.

ing inventories unless, at the time he files his application for the adoption of such method, he agrees to such adjustments incident to the change to or from such method, or incident to the use of such method, in the inventories of prior taxable years or otherwise, as the Commissioner upon the examination of the taxpayer's returns may deem necessary in order that the true income of the taxpayer will be clearly reflected for the years involved.

SEC. 19.22(d)–5. *Revocation of election.*—An election made to adopt and use the elective inventory method is irrevocable, and the method once adopted shall be used in all subsequent taxable years, unless the use of another method be required by the Commissioner, or authorized by him pursuant to a written application therefor filed with him as provided in section 19.41–2.

SEC. 19.22(d)–6. *Change from elective inventory method.*—If the taxpayer is granted permission by the Commissioner to discontinue the use of the elective method of taking inventories, and thereafter to pursue some other method, or if the taxpayer is required by the Commissioner to discontinue the use of the elective method by reason of the taxpayer's failure to conform to the requirements detailed in section 19.22(d)–2, the inventory of the specified goods for the first taxable year affected by the change and for each taxable year thereafter shall be taken—

(*a*) In conformity with the method used by the taxpayer under section 22(c) in inventorying goods not included in his elective inventory computations; or

(*b*) If the elective inventory method was used by the taxpayer with respect to all of his goods subject to inventory, then in conformity with the inventory method

used by the taxpayer prior to his adoption of the elective inventory method; or

(*c*) If the taxpayer had not used inventories prior to his adoption of the elective inventory method and had no goods currently subject to inventory by a method other than the elective method, then in conformity with such inventory method as may be selected by the taxpayer and approved by the Commissioner as resulting in a clear reflection of income; or

(*d*) In any event, in conformity with any inventory method to which the taxpayer may change pursuant to application approved by the Commissioner.

SEC. 19.22(d)–1. *Inventories under elective method.*—Any taxpayer permitted or required to take inventories pursuant to the provisions of section 22(c), and pursuant to the provisions of sections 19.22(c)–1 to 19.22(c)–8, inclusive, may elect with respect to those goods specified in his application and properly subject to inventory to compute his opening and closing inventories in accordance with the method provided by section 22(d), as amended. Under this elective inventory method, the taxpayer is permitted to treat those goods remaining on hand at the close of the taxable year as being:

First, those included in the opening inventory of the taxable year, in the order of acquisition and to the extent thereof, and

Second, those acquired during the taxable year.

This elective inventory method is not dependent upon the character of the business in which the taxpayer is engaged,

or upon the identity or want of identity through commingling of any of the goods on hand, and may be adopted by the taxpayer as of the close of any taxable year beginning after December 31, 1938.

If the elective inventory method is used by a taxpayer who regularly and consistently, in a manner similar to hedging on a futures market, matches purchases with sales, then firm purchase and sales contracts (i.e., those not legally subject to cancellation by either party) entered into at fixed prices on or before the date of the inventory may be included in purchases or sales, as the case may be, for the purpose of determining the cost of goods sold and the resulting profit or loss, provided that this practice is regularly and consistently adhered to by the taxpayer and that, in the opinion of the Commissioner, income is clearly reflected thereby.

*If a taxpayer using the retail method of pricing inventories, authorized by section 19.22(c)-8, elects to use in connection therewith the elective inventory method authorized by section 22(d) of the Code, the apparent cost of the goods on hand at the end of the year, determined pursuant to section 19.22(c)-8, shall be adjusted to the extent of price changes therein taking place subsequent to the close of the preceding taxable year. The amount of any apparent inventory increase or decrease to be eliminated in this adjustment shall be determined by reference to acceptable price indices established to the satisfaction of the Commissioner. Price indices prepared by the United States Bureau of Labor Statistics which are applicable to the goods in question will be considered acceptable to the Commissioner. Price indices which are based upon inadequate records, or which are not subject to complete and detailed audit within the Bureau, will not be approved.**

**Material in italics added by T. D. 5605, 1948-1 Cum. Bull. 16.

SEC. 19.22(d)-2. *Requirements incident to adoption and use of elective method.—Except as otherwise provided in section 19.22(d)-1 with respect to retail inventory computations,* the adoption and use of the elective inventory method is, by section 22(d) and regulations thereunder, made subject to the following requirements:*

(1) The taxpayer shall file an application to use such method specifying with particularity the goods to which it is to be applied;

(2) The inventory shall be taken at cost regardless of market values;

. . .

T.D. 5605, 1948-1 Cum. Bull. 16

TITLE 26—INTERNAL REVENUE—CHAPTER I, SUBCHAPTER A, PART 19 AND PART 29.

Regulations 103 and Regulations 111 amended with respect to elective inventory computations.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Collectors of Internal Revenue and Others Concerned:

On December 23, 1947, notice of proposed rule making regarding elective inventory computations in the case of retailers was published in the Federal Register (12 F. R. 8726). After consideration of all such relevant matter as was presented by interested persons regarding the proposal, the amendments to Regulations 103 [26 CFR, Part 19]

*Material in italics added by T. D. 5605, 1948-1 Cum. Bull. 16.

and to Regulations 111 [26 CFR, Part 29] set forth below are hereby adopted. The amendments are made in order to adapt the retail inventory requirements of the regulations to the elective inventory principle of section 22(d) of the Internal Revenue Code as enunciated by The Tax Court of the United States in *Hutzler Bros. Co.* (8 T. C., No. 3 [page 14]).

Paragraph 1. Section 29.22(c)-8 of Regulations 111 [26 CFR, 29.22(c)-8] and section 19.22(c)-8 of Regulations 103 as amended by Treasury Decision 5048, approved June 2, 1941 [C.B. 1941-1, 200] [26 CFR 19.22(c)-8], are further amended as follows:

(A) By inserting after the second paragraph in each case the following (except that, in Regulations 103, the cross-reference shall be made to section 19.22(d)-1):

For further adjustments to be made in the case of a retail merchant using the elective inventory method authorized by section 22(d), see section 29.22(d)-1.

(B) By striking from the beginning of the fourth paragraph in each case the words "A taxpayer," and by inserting in lieu thereof the following:

A taxpayer (other than one using the elective inventory method)

(C) By striking from the beginning of the last paragraph in each case the words "A taxpayer," and by inserting in lieu thereof the following:

A taxpayer (other than one using the elective inventory method)

(D) By inserting at the end thereof in each case the following:

A taxpayer using the elective inventory method in conjunction with retail computations must adjust retail selling prices for mark-downs as well as mark-ups, in order that there may be reflected the approximate cost of the goods on hand at the end of the year, regardless of market values.

Par. 2. Section 29.22(d)-1 of Regulations 111, as amended by Treasury Decision 5407, approved October 9, 1944 [C.B. 1944, 83] [26 CFR, 29.22(d)-1], and section 19.22(d)-1 of Regulations 103 [26 CFR, 19.22(d)-1] are further amended by inserting at the end thereof in each case the following (except that, in Regulations 103, the cross-reference shall be made to section 19.22(c)-8):

If a taxpayer using the retail method of pricing inventories, authorized by section 29.22(c)-8, elects to use in connection therewith the elective inventory method authorized by section 22(d) of the Code, the apparent cost of the goods on hand at the end of the year, determined pursuant to section 29.22(c)-8, shall be adjusted to the extent of price changes therein taking place subsequent to the close of the preceding taxable year. The amount of any apparent inventory increase or decrease to be eliminated in this adjustment shall be determined by reference to acceptable price indices established to the satisfaction of the Commissioner. Price indices prepared by the United States Bureau of Labor Statistics which are applicable to the goods in question will be considered acceptable to the Commissioner. Price indices which are based upon inadequate records, or which

are not subject to complete and detailed audit within the Bureau, will not be approved.

Par. 3. Section 29.22(d)-2 of Regulations 111, as amended by Treasury Decision 5504, approved March 20, 1946 [C.B. 1946-1, 52] [26 CFR, 29.22(d)-2], is further amended by revising that portion thereof preceding the numbered paragraphs to read as follows:

Sec. 29.22(d)-2. Requirements Incident to Adoption and Use of Elective Method.—Except as otherwise provided in section 29.22(d)-1 with respect to raw material computations and with respect to retail inventory computations, the adoption and use of the elective inventory method is, by section 22(d) and regulations thereunder, made subject to the following requirements:

Par. 4. Section 19.22(d)-2 of Regulations 103, as amended by Treasury Decision 5199, approved December 10, 1942 [C.B. 1942-2,81] [26 CFR, 19.22(d)-2], is further amended by revising that portion thereof preceding the numbered paragraphs to read as follows:

Sec. 19.22(d)-2. Requirements Incident to Adoption and Use of Elective Method.—Except as otherwise provided in section 19.22(d)-1 with respect to retail inventory computations, the adoption and use of the elective inventory method is, by section 22(d) and regulations thereunder, made subject to the following requirements:

Par. 5. The amendments made by this Treasury decision shall be applicable to all taxable years beginning after December 31, 1938.

(This Treasury decision is issued under the authority contained in sections 62 and 22(d) of the Internal Revenue Code (53 Stat., 32, 11; 26 U. S. C., 62, 22(d)).)

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved March 4, 1948.

A. L. M. WIGGINS,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register March 9, 1948, 8.55 a.m.)

Rulings

Mim. 6244, 1948-1 Cum. Bull. 21

Use of elective inventory method by taxpayers using retail inventory method.

TREASURY DEPARTMENT
OFFICE OF COMMISSIONER OF INTERNAL REVENUE.
Washington 25, D. C., March 9, 1948.

Collectors of Internal Revenue, Internal Revenue Agents in Charge; Heads of Field Divisions of the Technical Staff, and Others Concerned:

1. Section 22(d)(1) of the Internal Revenue Code provides an elective method for inventorying goods, commonly referred to as the last-in, first-out, or LIFO, inventory method. Section 22(d)(2)(A) of the Code provides that the elective method shall be applied only with respect to the goods specified by the taxpayer in an application filed with the Commissioner. The Commissioner's regulations

with respect to the elective inventory method have heretofore made no provision for retailers to group such goods into classes. The Bureau has held that the use of the elective inventory method was not available to taxpayers whose inventory records are kept on the basis of the retail inventory method permitted under section 29.22(c)-8 of Regulations 111 and section 19.22(c)-8 of Regulations 103.

2. The Tax Court held in the case of *Hutzler Bros. Co. v. Commissioner* (8 T. C., 14) that a taxpayer using the retail inventory method is entitled to use the elective inventory method. The grouping of goods by classes under the retail inventory method necessarily involves the use of some type of index numbers for measuring the extent of price changes in the various classes of goods concerned. The decision laid down no rule concerning the nature or type of index numbers which might be proper, nor did it prescribe other details of methods for applying the Lifo method in the case of retail merchants.

3. Treasury Decision 5605, approved March 4, 1948 [page 16, this Bulletin], amends Regulations 103 and 111 to expressly permit the use of the elective inventory method by taxpayers using the retail inventory method. Certain principles are laid down for the application of the elective inventory method by such taxpayers. First, since the elective method requires the use of cost, the retail selling prices of goods included in the opening inventory and purchased during the year must be adjusted for mark-downs as well as mark-ups during the year without regard to the taxpayer's previous practice with respect to mark-downs under the retail method. This requirement does not apply to retailers employing the retail inventory method without the use of the elective method. Second, the price indices em-

ployed in the adjustment of the apparent cost of goods in the closing inventory for price changes taking place during the year must be shown, to the satisfaction of the Commissioner, to be acceptable. Any price indices must be based upon sound statistical principles of construction and upon adequate records to be kept available for examination by the Bureau.

4. Arrangements have been made between representatives of the retail trade and the United States Bureau of Labor Statistics for that agency to compute and publish a series of group index numbers of retail prices, on a country-wide basis, suitable for use by individual department stores, which will be acceptable to the Commissioner. These index numbers will cover the period from 1941 to the present on a semiannual basis, and will appear semiannually in the future. The use of such indices of the Bureau of Labor Statistics is not mandatory; indices may be prepared by an individual taxpayer based upon his own data on prices and inventory quantities, if adequate, and if proof is submitted that sound statistical methods have been employed that assure reliable indices, not only for the particular year in question, but for subsequent years. Retailers who have filed, on the basis of the elective method, returns for past years which are still open, and who used indices that are not acceptable to the Commissioner, may file amended returns employing acceptable indices.

5. Index numbers for the years ended January, 1941 to 1947, inclusive, were published by the Bureau of Labor Statistics on January 7, 1948, and similar data for July of those years was published on February 3, 1948. Semiannual indices for January 15 and July 15 will be published.

in the future, in March and September of each year. Indices as of the 15th of a month will be deemed to be representative of prices at either the beginning or end of such month. These releases of the Bureau of Labor Statistics will also be published in the Internal Revenue Bulletin.

6. The following groups have been used by the Bureau of Labor Statistics as the basis for the preparation of the indices for past years for use by department stores:

I. Piece goods, domestics, and draperies.
II. Shoes.
III. Ladies' underwear.
IV. Ladies' outerwear and girls' wear.
V. Men's and boys' wear.
VI. Furniture and bedding.
VII. Home furnishings.
VIII. Major appliances and electrical goods.
IX. Notions and toilet articles.

Beginning with January, 1948, price data will be gathered on additional commodities that may allow the segregation of additional groups. The Bureau of Labor Statistics shows in Table III of its release of January 7, 1948, the coverage of each of the above groups, by naming the departments of a typical department store, as described by the Controller's Congress of the National Retail Dry Goods Association, which are included in each group.

7. In using such group indices, a department store taxpayer will apply to the inventory data for each of his departments separately, in the manner described below, the index for the group in which the department logically belongs. A given group index may be applicable to a number of departments in a store.

8. The problem arises of what indices are to be employed for a department which does not fit into any one of the nine groups named above. In this case an index should be employed which represents an average for the whole of the remainder of the store. For example, this index may be the store total, as shown by the Bureau of Labor Statistics, or that shown for apparel, piece goods, and notions combined (groups I, II, III, IV, V, and IX), whichever of these combinations more closely represents the coverage of the inventory stock carried by the store.

9. The method of making the first-year price adjustments to the closing inventory values under the retail inventory method, combined with the elective (LIFO) method, is illustrated in Exhibits A and B, hereafter set forth, for three hypothetical departments. In the first two departments there was an increase in the physical quantity of inventory during the year in question, as shown by the comparison of the adjusted retail value at the end of the year and the retail value at the beginning of the year. In the first department prices rose during the year, as shown by the index, while in the second, prices fell. In the third department there was a decline in the physical quantity of inventory.

10. To illustrate further the principles involved, Exhibits C and D show the adjustments for two additional years for department 1, the data for the first year being repeated to show the continuity. It is assumed that the physical quantity of inventory increased in the first two years, but decreased in the third year, as indicated by the adjusted retail values. It is to be noted that the decrease in the third year eliminated all of the second year increase, and part of the first year's increase, *in that order*, retaining in the closing inventory the merchandise appearing in the

opening inventory "in the order of acquisition." Thus, it is necessary under the elective method to retain the identity of each annual increment to the inventory of each department. The price changes are measured by reference to the fixed prices at the beginning of the first LIFO year and the retail inventory value on each inventory date is adjusted to the price level on that date.

11. These illustrations are intended to show the main principles involved in the LIFO adjustments to retail inventories, and are not intended to cover all accounting details of computations which may be required, particularly in later years, under the elective method.

12. Correspondence regarding this mimeograph should refer to its number and the symbols indicated for the appropriate Bureau office concerned: Collectors of internal revenue, A&C: Col; internal revenue agents in charge, IT:EIM; and heads of field divisions of the Technical Staff, TS:ARM.

GEO. J. SCHOENEMAN,
Commissioner.

MISCELLANEOUS

The following is an extract, copied by hand from the files of the office of the United States Attorney for the Southern District of New York, of a press release prepared by Paul W. Williams, then the United States Attorney, summarizing the activities of his office for the fiscal year ended June 30, 1958:

JJL:sq

For release Mon. Morning papers
July 7, 1958

PRESS RELEASE

"Paul W. Williams, United States Attorney for the Southern District of New York, today released the annual statistical report of his office's operations for the fiscal year ending June 30, 1958. During this period Mr. Williams began 1,896 cases, of which 1,018 were criminal prosecutions, and he closed 1,956 cases, thus reducing by 60 the number of cases awaiting trial.

"* * *

"Civil litigation was equally successful, Mr. Williams reported. In proceedings in federal and State courts, he recovered civil judgments for the United States of $2,763,412.37, of which $645,936.39 has already been collected.

"In a recent tax refund action, R. H. Macy & Co. sought to recover $1,200,000.00 from the Federal Government for one tax year alone. The identical issue was involved in refund claims for five other tax years, and a victory for R. H. Macy & Co. would have resulted in a net loss to the Government of some $12,000,000.00. In addition, there were other department stores throughout the United

States with identical claims estimated variously between $300,000,000.00 and one billion dollars.

"Mr. Williams was successful in winning this action for the Government before the United States Court of Appeals for the Second Circuit. The complaint was dismissed, resulting in enormous savings to the Government.

"Mr. Williams praised the work of his staff and pointed to these accomplishments of the past fiscal year as indicative of the characteristic quality and quantity of the legal work performed by the office of the United States Attorney for the Southern District of New York."

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FILED
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JAMES R.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 369

R. H. MACY & CO., INC., L. BAMBERGER & CO., DAVISON-PAXON CO., and THE LASALLE & KOCH COMPANY,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONERS

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October 24, 1958.

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IN THE

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OCTOBER TERM, 1958

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Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

No. 369

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONERS

The Government has conceded that the LIFO statute accords taxpayers, including retail method taxpayers such as Macy, a right to elect LIFO for fiscal 1942, but only pursuant to regulations prescribed by the Commissioner.* (See, *e.g.*, Sec. 22(d)(2)(A) of the Code; App. 63-64.) The position of the Government here (GB 9-13) and of the court below (App. 11-12) is, therefore, not only (i) that the original LIFO regulation applied to retail method taxpayers but (ii) that whether or not applicable by its terms, the right to challenge that regulation by such tax-

*As noted by the court below:

". . . Both Macy and the government agree that the statutory right to elect LIFO was not absolute, but was conditioned upon compliance with appropriate regulations to be issued by the Commissioner . . ." (App. 7).

payers was the equivalent of their statutory right to elect LIFO.

Both the Government here and the court below arrive at their conclusion that the original LIFO regulation was applicable to retail method taxpayers by ignoring (i) the rule in *Bowles* v. *Seminole Rock Co.*, 325 U. S. 410, that the meaning of a federal administrative regulation is to be sought in the intention and interpretation of the promulgating administrator, and (ii) the fact that the original LIFO regulation contained an absolute bar to its utilization by retail method taxpayers. Although expressly relied upon in the petition (Pet. 6, 8, 14, 16), the entirety of the Government's brief is built upon an avoidance of that settled rule and that overwhelmingly significant fact.

1. (a) In the petition (Pet. 6, 8, 16), Macy stressed that the original LIFO regulation contained requirements for "matching of goods" which made compliance with that regulation impossible for retail method taxpayers. The requirements for "matching of goods" are found in subdivision 19.22(d)-2 of the original LIFO regulation (App. 69-74). They are couched in terms of specifying with "particularity" the goods to which LIFO may be applied and of computing opening inventories and increases in closing inventories over opening inventories by "units" and "unit costs", language *not* found in the LIFO statute.*

The necessary effect of the Commissioner's incorporation in the original LIFO regulation of requirements for "matching of goods" was affirmatively to bar compliance with the original LIFO regulation by retail method tax-

*It is clear from the opinion below (App. 9, fn. 4) that the court of appeals believed that the LIFO statute contained "similar language" to the phrases "specifying with particularity", "unit costs", and "units" which the Commissioner included in the original LIFO regulation. Neither those phrases, nor similar phrases, are found in the LIFO statute (which simply uses the phrase "goods specified in the application"). Compare App. 63-65 with App. 68-74.

payers. In Paragraph 7 of the Stipulation of Facts (App. 46-47), the Government conceded this fact, *viz.*, that inventorying "in terms of specific goods . . . is not practicable" for retail method taxpayers.

The Government also has omitted discussion of another stipulated fact (App. 55) which shows the inapplicability of the original LIFO regulation to retail method taxpayers —*i.e.*, the Commissioner's 1948 amendment of that regulation. Those amendments, retroactive to 1938, specifically exempt retail method taxpayers from compliance with the "matching of goods" requirements of the original LIFO regulation and are an incontestable acknowledgment that a retail method taxpayer could not have complied with the original LIFO regulation (App. 79-88). Hence, the original LIFO regulation accorded retail method taxpayers only the right "either to acquiesce . . . or . . . challenge it" (GB 12).

By refusing to acknowledge that the original LIFO regulation made election of LIFO by retail method taxpayers impossible, the Government has felt free to suggest that although

> ". . . the Commissioner believed that the [LIFO] statute did not apply [to retail method taxpayers] does not mean that he intended his regulations . . . to foreclose the issue" (GB 9).

Of course, the intention of the Commissioner to "foreclose" or not to "foreclose" the issue is now academic, since he in fact did foreclose it by promulgating the "matching of goods" requirements of the original LIFO regulation. Moreover, it is perfectly clear from the following arguments of the Commissioner to the Tax Court in *Hutzler Brothers Company*, 8 T. C. 14 (1947), that he had intended, in promulgating the original LIFO regulation, to foreclose the election of LIFO by retail method taxpayers:

> ". . . The regulations leave no room for doubt, as authorized by Sections 22(c) and 22(d)(3) of the Code, that there must be a matching of articles of goods on hand at the end of the year with similar articles of goods on hand at the beginning of the year. This is further established by the language used in Section 19.22(d)-2 (2) of Regulations 103, as amended, which requires the petitioner to specify 'with particularity' the goods to which the elective method is to be applied.
>
> ". . .
>
> ". . . That Section [19.22(d)-2] throughout refers to specific units acquired at specific times and at specific prices. In no place does the Commissioner prescribe that the retail method provided in Section 19.22(c)-8 of the Regulations, or any modification thereof, may be used under Section 22(d) of the Code . . ." (*Brief for Respondent*, Docket No. 4083, Tax Court of the United States, pp. 45, 50-51).

As already noted, the Government has stipulated in this case that the "matching of goods" requirements of the original LIFO regulation made that regulation unusable by retail method taxpayers. It cannot be rationally contended that promulgation of a regulation setting a time to elect LIFO subject to compliance with impossible requirements accords to taxpayers barred by those requirements that right to elect LIFO intended by Congress.

(b) The Government also argues that the decision below was correct for a reason neither reached nor discussed by the court below, *i.e.*, that even if the remainder of the original LIFO regulation was inapplicable to retail method taxpayers, the subdivision which required filing on Treasury Form 970 of an election to use LIFO (Regs. 103, Sec. 19.22(d)-3; App. 74-75) was applicable to such taxpayers. That argument is absurd.

The subdivision to which the Government refers expressly required filing Treasury Form 970 "pursuant to the

instructions printed thereon and to the requirements of this section". As noted above, among such requirements were the requirements for "matching of goods" with which retail method taxpayers could not comply. In addition, Treasury Form 970 specifically referred to that subdivision (19.22(d)-2) of the original LIFO regulation which embodied the "matching of goods" requirements. The instructions on the Form required that the taxpayer "specify with particularity the goods" as to which the election is made and that there be attached to the Form "an analysis of all inventories of the taxpayer . . . prepared in detail in accordance with existing regulations". Finally, the Form required an affidavit by the taxpayer that its application for election of LIFO is "made . . . pursuant to the requirements of . . . the regulations".

In an attempt to avoid the plain meaning of the "*Time and Manner of Making Election*" subdivision (19.22(d)-3) of the original LIFO regulation, the Government suggests an ingenious rationale. It suggests that the Commissioner intended by that subdivision to force binding elections between LIFO and FIFO upon all taxpayers, even those whose right to use LIFO he had barred in the remainder of the regulation. The ingenious rationale for this anomalous act is that the Commissioner promulgated the "*Time and Manner of Making Election*" subdivision in order to deprive barred taxpayers of the benefit of hindsight should the Commissioner's interpretation of the LIFO statute, as embodied in the regulation, later be held erroneous. That rationale does not bear analysis. As noted in the petition (Pet. 19 fn.*), the mere filing prior to 1948 of Treasury Form 970 by a retail method taxpayer did not constitute a binding election of LIFO, since until that time it was always open to the taxpayer to acquiesce in the Commissioner's position. Thus, as the district court perceived, (i) it violates every canon of construction to read the "*Time and Manner*

of Making Election" subdivision of the original LIFO regulation "*in vacuuo* and isolated from the other subdivisions" and (ii) it "would be rationally offensive to make provision for the time and manner of the filing of a statement of election by one in whom, it is asserted, the right to make an election does not reside, and to whom the right to make the election is denied" (App. 31, 32).

* * *

Clearly, the original LIFO regulation did not accord retail method taxpayers the right to elect LIFO. To be sure, those taxpayers had a right to litigate the correctness of that regulation (the course chosen in *Hutzler*). But to allow this does not answer the questions: (i) when did the right of retail method taxpayers to elect LIFO, pursuant to a regulation issued by the Commissioner, first come into being, and (ii) does the right to litigate the validity of a regulation satisfy the Congressional mandate that retail method taxpayers be accorded the right to elect LIFO under a regulation to be prescribed by the Commissioner. Immanent in the answers to those questions are answers to questions of critical importance in the fields of federal tax law and in administrative law generally.

2. Refusing to recognize the inapplicability of the original LIFO regulation to retail method taxpayers or, alternatively, assuming it sufficient that those taxpayers had a right to challenge that regulation, the Government declares each case relied upon in the petition as in conflict with the decision below to be either not "in point", without "conceivable relevance" or only "remotely in point".

(a) The Government bends both *Pictorial Review Co. v. Helvering*, 68 F. 2d 700 (D. C. Cir. 1934), and this case in an effort to destroy the clear parallelism between them. Thus, the Government first attempts to distinguish *Pictorial Review* by urging that here, in contrast to that case, "the 'right of election' was admittedly 'in being' all of the time" (GB 14, fn. 8). That is patent question begging for the Government has unequivocally asserted that

". . . The sole issue in this case is whether [the original LIFO regulation] was applicable to [retail method taxpayers]" (GB 8-9).

The Government also seeks to distinguish *Pictorial Review* by suggesting that, in contrast to the instant case, the original regulation in that case was "valid" (GB 13). To the extent that the Government is implying that the original LIFO regulation was "invalid," it is arguing that that regulation was inapplicable to, and, hence, not binding on, retail method taxpayers. If the Government is using the word "invalid" in the same sense as that word was used by this Court in *Manhattan Co. v. Commissioner*, 297 U. S. 129, it is admitting a conflict between this case and *Manhattan Co.* Unless the Government is arguing that the original LIFO regulation was invalid as to retail method taxpayers, the distinction it perceives between *Pictorial Review* and this case is incomprehensible.

Finally, the Government asserts that the "whole point" of *Pictorial Review* is that the initial regulation there was "binding" on the taxpayer and "*could not* have been successfully challenged" (GB 14, fn. 8)—obviously in contrast to the Government's view that the original LIFO regulation was open to challenge by retail method taxpayers. This distorts the meaning of *Pictorial Review* which describes the Commissioner's initial regulation there as "binding" solely as a bridge to the conclusion that Excella, by failing to challenge the initial regulation, had *not* excluded itself from exercising its right of election following promulgation of an amended regulation curing the Commissioner's misconstruction of the statute. Surely the court of appeals in *Pictorial Review* did not hold that an election regulation which misconstrues a statute cannot be successfully challenged by a taxpayer who wishes to do so—it simply held that a taxpayer has no obligation to do so.

The clear holding of *Pictorial Review* (patently in conflict with the decision below) is that where Congress has accorded a right of election to be exercised pursuant to an administrative regulation, the promulgating administrator

must accord a free choice between the alternatives to be elected and not a choice between litigating the validity of a regulation or being held to have elected by acquiescence. Contrary to the Government and the court below, Congress intended that the LIFO regulation give retail method taxpayers a choice between LIFO and FIFO, not a choice between litigation and FIFO.

(b) The Government implicitly concedes that the decision of this Court in *Manhattan Co.* v. *Commissioner*, 297 U.S. 129, would be relevant and in conflict with the decision below if the original LIFO regulation were invalid with respect to retail method taxpayers (GB 15). Since it is principally by suggesting "invalidity" that the Government seeks to distinguish *Pictorial Review* (GB 14, fn. 8), the Government must concede conflict either with *Manhattan Co.* or with *Pictorial Review*.

(c) The Government admits that *Joseph Horne Co.* v. *United States*, 161 F. Supp. 580 (Ct. Cl. 1958), may be in conflict with the decision below in so far as *Horne* held that the original LIFO regulation had not "prescribed the procedures or standards to be followed by retail method taxpayers in using the LIFO method" (GB 16). The Government's only answer to that conflicting aspect of *Horne* is to suggest that the *Horne* case was incorrectly decided. Whether or not *Horne* was correctly decided, the Government cannot now deny the conflict in view of its own vigorous assertion of conflict on its motion for rehearing in *Horne* (see Pet. 17).*

*The Government attempts to counteract the *Horne* conflict by citing *Kaufmann & Baer Co.* v. *United States*, 133 Ct. Cl. 510, 137 F. Supp. 725 (1956); *cert. denied*, 352 U.S. 835. That the decision below may be in accord with *Kaufmann & Baer* would hardly vitiate the conflict of both of those decisions with *Pictorial Review*, *Manhattan Co.* and *Horne*. In any event, it is obvious from the unique factual situation in *Kaufmann & Baer* (GB 15) that that case should not be dispositive of the claims of the vast majority of retail method taxpayers.

3. The Government concedes, subject to a quibble over the dollar volume of claims thus far actually filed by retail method taxpayers, that on the decision in this case hinges disposition of similar claims involving, in the aggregate, "between $300,000,000 and one billion dollars" (GB 16).

The Government also seems to concede that the net effect of the Commissioner's administration of the LIFO statute, through his original LIFO regulation, has been to deprive the majority of retail method taxpayers of the right to elect LIFO for fiscal years prior to 1948. The Government's boast of the Commissioner's acquiescence in *Hutzler* and his extension since 1948 to retail method taxpayers of the right to elect LIFO for current tax years (GB 17) does not cure the continuing failure of the Commissioner to extend that right to such taxpayers for tax years prior to 1948. Certainly, the fact that the Commissioner may be properly administering the LIFO statute for fiscal years since 1948 does not justify maladministration, with the sanction of the court below, of that statute for all years prior to 1948.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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October 24, 1958.